IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. 352

GENERAL MOTORS CORPORATION, *Petitioner*

v.

DISTRICT OF COLUMBIA, *Respondent*

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR THE PETITIONER

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The findings of fact and opinion, as amended, of the District of Columbia Tax Court are not officially reported. The printed record (R. 436-473; 491-497) contains the Tax Court's original findings and opinion and its order modifying them. For the convenience of the Court, we have made the directed changes and printed the complete findings and opinion as modified in Appendix A hereto, p. 1a, *infra*. The majority

and dissenting opinions of a division of the Court of Appeals (O.R. 592) are not officially reported. The majority and dissenting opinions of the Court of Appeals on rehearing *en banc* (R. 498-532) are reported at 336 F.2d 885. The opinions modifying the judgments (R. 533-535) are reported at 336 F.2d 904.

JURISDICTION

The judgments, as modified, of the Court of Appeals were entered May 7, 1964, 336 F.2d 904 (R. 536). Petition for writ of certiorari was filed August 5, 1964, and granted October 26, 1964, 379 U.S. 887. The jurisdiction of this Court rests on 62 Stat. 928, 28 U.S.C. 1254(1).

QUESTIONS PRESENTED[1]

I. Interstate Commerce, Due Process and Territorial Jurisdiction

Whether the single-factor sales formula for the "apportionment" of net income, prescribed by the Commissioners of the District of Columbia purportedly under authority of the District of Columbia Income and Franchise Tax Act of 1947, is invalid:

(a) as repugnant to the Due Process Clause of the Fifth Amendment to the Constitution;

(b) as repugnant to the Commerce Clause of the Constitution; or

(c) as unconstitutionally extending the power of the Commissioners beyond their territorial jurisdiction;

when the application of such formula results in the taxation by the District of 100 percent of the net in-

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[1] Reprinted verbatim from the petition.

come of a foreign corporation derived from that segment of its business consisting of the manufacture and sale of products without the District to customers within the District, thus

(1) taxing extraterritorial values and assigning to the District values which belong to, and have been properly taxed by, other states;

(2) imposing upon interstate commerce cumulative tax burdens (double taxation) to which local commerce is not subject; and

(3) subjecting to District tax an amount of income out of all reasonable proportion to the business actually "carried on or engaged in" within the District.

II. Statutory Construction

Whether the District of Columbia Income and Franchise Tax Act of 1947, which imposes a franchise tax on corporations carrying on business within and without the District, measured by net income "fairly attributable" to District business, permits the adoption by regulation of the District Commissioners of a single-factor sales formula to determine the amount of such taxable income, when the application of such formula subjects to District tax 100 percent of the net income of a foreign corporation derived from that segment of its business consisting of the manufacture and sale of products without the District to customers within the District, a percentage which is out of all reasonable proportion to the business carried on within the District.

CONSTITUTIONAL PROVISIONS, STATUTES, AND REGULATIONS INVOLVED

Art. I, § 8, cl. 3 of the Constitution of the United States and the Due Process Clause of the Fifth Amendment thereto are set forth in Appendix B-1, p. 30a, *infra.*

The pertinent sections of the District of Columbia Income and Franchise Tax Act of 1947, being §§ 47-1551c(h), 47-1580 and 47-1580a of the D.C. Code 1961, are set forth in Appendix B-2, p. 30a, *infra.*

The pertinent sections of the District Commissioners' Regulations of August 6, 1953 (as relettered by amendment of July 24, 1956), and an excerpt from the Regulations of July 14, 1961, are set forth in Appendix B-3 and B-4, p. 33a, *infra.*

The pertinent sections of the laws of Delaware, Maryland and Michigan are set forth in Appendix B-5, p. 38a, *infra.*

STATEMENT OF THE CASE

Petitioner, General Motors Corporation, brought proceedings in the District of Columbia Tax Court for the review of franchise tax deficiencies for the taxable years 1957 and 1958 assessed by respondent, District of Columbia, purportedly pursuant to the District of Columbia Income and Franchise Tax Act of 1947 (D.C. Code 1961, §§ 47-1551 *et seq.*); and for refund of the taxes and interest so assessed and paid under protest (O.R. 1-37).

Petitioner is a Delaware corporation, qualified to do business in the District (R. 372). In the taxable years involved, it was engaged principally in the manufacture and sale of motor vehicles, parts and acces-

sories. Such manufacture was carried on wholly outside the District (R. 261) and, as to the products sold and shipped to District customers, very largely in Michigan, Delaware and Maryland (R. 437). Petitioner's products were sold to customers (principally automobile retail dealers) whose places of business were in the District; the orders were received and filled, and title passed, outside the District, and the products were shipped to the customers from outside the District (R. 261-300, 504). Not only the entire manufacturing activity but most of the selling activity was carried on outside the District. With very minor exceptions, the sales offices were outside the District.[2] Personnel from those outside offices, none of whom resided in the District, regularly called on customers in the District for promotional purposes and assisted in improving their operations (R. 262-282, 294-300).[3] Several small offices were maintained in the District (*e.g.*, a public relations office, a patent office, and certain offices for government contract liaison), but their

[2] United Motors Service Division had a Zone Office in the District in 1957 and during the first six months of 1958, its sales being the basis of the tax originally paid by petitioner (R. 294, 373). Chevrolet Division maintained in the District a Regional Office, which had one employee whose duties were to assist fleet users throughout the Region in several states, and where one employee of the Zone Office (located in Baltimore) was assigned space. Except for these employees, the office itself performed no functions directly related to sales, but provided administrative supervision over five Zone Offices located outside the District (R. 270-271).

[3] The Court of Appeals dwelt at some length on the activities of petitioner's sales personnel in the District (R. 506-509). It may help to put such activities in perspective to note that the total amount of compensation allocable to the time which all such transient personnel (making regular visits to the District one or more times a month) spent in the District was $65,099 in 1957 and $75,694 in 1958 (R. 387).

presence had no bearing on the amount of the assessments (R. 285-294, 300-306).

Petitioner's customers, who are independent businessmen, operate under dealer selling agreements which prescribe certain standards of management and performance (R. 282-284, 296, 300, 307-346, 505). In certain instances, petitioner and a subsidiary provide financing for dealers (R. 302-304, 347-371, 384, 505-506). The dealers pay District taxes on their own profits; and petitioner and its subsidiary have paid taxes without controversy on income from financing the dealers (R. 375). The nature of petitioner's relationship to the dealers is not in issue in this case.

The District of Columbia Income and Franchise Tax Act of 1947, *supra,* imposes a tax on the privilege of carrying on business within the District,[4] measured by the portion of net income fairly attributable to the District business, leaving the determination of such portion to regulations of the Commissioners.[5] The Commissioners prescribed a formula under which the total net income was multiplied by a fraction the numerator of which comprised "District sales" and the denominator of which was total sales everywhere.[6] As applied by the Finance Officer, "District sales" was treated as embracing all sales in which the goods were shipped to a District customer at a location in the

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[4] It is not denied that petitioner was carrying on business in the District and that the District has jurisdiction to tax.

[5] D.C. Code 1961, §§ 47-1580, 1580a, App. B, pp. 31a-33a, *infra,* Part IV of the Tax Court's opinion contains a helpful discussion of the history of the statute (R. 447-450; App. A, pp. 13a-16a, *infra*).

[6] Appendix B, p. 33a, *infra.*

District (R. 372-374).[7] In other words, he determined and taxed the total profit realized on all business culminating in sales to customers located in the District (on the assumption, valid for this purpose, that each sale was equally profitable). This method is referred to herein as a "single-factor sales formula" using the "destination sales" test, in contrast to apportionment formulae which take into account the contribution of capital and labor to the production of income.

The District accordingly assessed deficiencies for the years 1957 and 1958 (R. 372-375). After exhausting its administrative remedies, petitioner paid under protest the assessed deficiencies, together with interest thereon, and brought proceedings in the District of Columbia Tax Court for review of the assessments and for refund of the taxes and interest paid (R. 375-376).

In addition to the facts stipulated, the Tax Court made the following *findings of fact:* Petitioner's central offices were in Michigan and New York. It had business establishments in 38 states and the District. Finding 1, R. 437; App. A, p. 1a, *infra.* There was no factory in the District. About half of all manufacturing activities were in Michigan. The vehicles sold to District customers were manufactured principally in Michigan, Maryland and Delaware. Finding 2, R. 437; App. A, pp. 1a-2a, *infra.* The segment of petitioner's business which was conducted both within and without the District consisted of the manufacture of motor

[7] Petitioner had originally paid tax on the basis of a different interpretation of what constituted "District sales" within the meaning of the regulation. That question of applying the regulation to the facts is not before this Court, but will be determined on remand if this Court upholds the regulation (R. 533-535).

vehicles and related products without the District and their sale to customers located within the District. The net income from this segment of the business was earned by a series of transactions, including procurement of material, use of property, financing and manufacture in various states and ending with sales to customers located in the District. Finding 5, R. 495-496; App. A, p. 3a, *infra.* The single-factor sales formula used in determining taxable net income assigned to the District 100 percent of the net income arising from that segment of the business and was out of all reasonable proportion to the trade or business carried on or engaged in by petitioner in the District. Finding 6, R. 496; App. A, p. 3a, *infra.* A portion of the net income derived from that segment of the business consisting of the manufacture without the District and sale to dealers in the District was taxed in Michigan, Maryland and Delaware, the states of manufacture, pursuant to apportionment formulae provided in their income-based tax laws. The taxes so paid were \$510,792.31 to Maryland and \$8,955,799.55 to Michigan in 1957, and \$127,844.95 to Delaware, \$271,425.75 to Maryland and \$6,940,309.50 to Michigan in 1958. Findings 3(a), 3(b), R. 437-438, 495; App. A, p. 2a, *infra.*[8]

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[8] There are numerous places in the findings and opinion of the Tax Court, in the opinion of the Court of Appeals, in the record and in the briefs, where there appear such phrases as "sales within the District" and "manufactured without but sold within the District". These are convenient shorthand, but it must be understood, as it was by the parties and both courts below (R. 192, 228, 504) that "sales [or sold] within the District" means only that the customers were located in the District, and does not refer to any selling activity of petitioner within the District. Every element of most sales took place outside the District, and the only related in-District activity was the liaison work of traveling personnel (R. 266, 268, 269, 270. 276, 280, 281, 295, 299).

Based on such findings, which the District did not challenge in the Court of Appeals (except for the ultimate conclusions), the Tax Court held that on the record the single-factor sales formula as applied produced an arbitrary and unreasonable result, violating the apportionment provisions of the Act (D.C. Code 1961 §§ 47-1580, 47-1580a), since the formula *identified*, but did not *apportion*, the income derived from petitioner's business conducted within and without the District. Thus it invalidated the formula as applied and redetermined the tax deficiencies using a three-factor formula of property, payroll and sales, each factor receiving equal weight, as the method best suited to determine the portion of petitioner's business income subject to tax. It did not reach the constitutional questions raised. (R. 436-473, 491-497; App. A, p. 1a, *infra.*)

The District appealed the Tax Court decisions to the Court of Appeals for the District of Columbia Circuit. On February 21, 1963, a division of the court, one judge dissenting, affirmed the Tax Court (O.R. 592). That court granted, on April 18, 1963, the District's petition for rehearing *en banc,* and on February 13, 1964, five judges reversed the decisions of the division and of the Tax Court and affirmed the deficiency assessments, deciding the statutory and constitutional questions adversely to petitioner (R. 498-527). Four judges dissented, one concurring in part (R. 528-532). Petitioner timely filed on February 25, 1964, a petition for rehearing to modify the judgments of February 13, 1964, which petition was granted on May 7, 1964. The judgments, as modified, sustain the use of the single-factor sales formula but leave for subsequent determination what sales are "District sales" (R. 533-535).

SUMMARY OF ARGUMENT

The case presents two questions: whether the assessments are a permissible construction of the statute; and whether they transcend constitutional limitations. In our petition for certiorari we put the constitutional aspects first because of their greater importance to this Court, and that order is carried over into our statement of Questions Presented (p. 2, *supra*). However, in the light of this Court's well-settled doctrine that it will not reach constitutional questions when the case can be decided on statutory grounds, we have reversed the order of argument in this brief on the merits. Much of the material pertinent to both sections of the brief appears in the statutory section and is not repeated in the constitutional section.

I. The Assessments Are Contrary to the Statute

The District of Columbia Income and Franchise Tax Act of 1947 clearly contemplates confining the tax base to net income derived from or "fairly attributable" to business activities carried on in the District. The location of customers has little or nothing to do with the place where such activities are carried on. In applying to petitioner's total net income the ratio of receipts from sales to customers in the District to receipts from sales everywhere, the Finance Officer accomplished no more than to identify the *entire* net income from that segment of petitioner's business culminating in sales to District customers, which segment of the business was almost entirely carried on in other jurisdictions (where the products were manufactured and the sales themselves were consummated).

The formula so applied did not *apportion* the net income from such business, as the statute directs. An

"apportionment" is not accomplished merely by dividing the entire net income into taxable and nontaxable parts, exempting from tax the part having no connection whatever with the District, and taxing in its entirety the net income having even the most limited and partial connection with the District. Nothing in the legislative history indicates that Congress approved or intended such method of determining the taxable net income.

II. The Assessments Are Unconstitutional

If, however, the statutory grant of power to the District Commissioners to provide apportionment formulae by regulations is construed to be broad enough to permit what was done, the regulations are unconstitutional. The Due Process and Commerce Clauses of the Constitution prohibit the District Commissioners, as well as the states, from taxing transactions and values beyond their territorial jurisdiction. Taxation of the net income from interstate business is permitted only when such net income is fairly apportioned among the jurisdictions where the income was produced. It is established by expert testimony and findings of fact herein, and as a matter of law by this Court, that income is derived from labor, capital or both combined. It is further established as a fact in this case that petitioner's income which the District assessed is derived primarily from manufacturing (and selling) activities without the District, and that the contribution of each productive element at each location can with acceptable accuracy be measured by the costs thereof. Applying such measures shows clearly that the assessments (a) are grossly excessive in relation to activities within the District, and (b) reach values outside the territorial jurisdic-

tion of the District, for which reasons they are repugnant to the Due Process and Commerce Clauses.

Substantial portions of the same income which the District has assessed have been properly taxed in other states. The resultant double taxation is the fault of the peculiar method of "apportionment" used by the District, and under these facts is a constitutionally forbidden discrimination against interstate commerce.

If the decision below is upheld, other states will be encouraged to adopt the single-factor sales formula in order to gain competitive advantages for local producers and to impose discriminatory tax burdens on outside corporations, large and small, which sell into such states. The Constitution forbids the use of the taxing power for the purpose of establishing economic barriers against interstate competition.

ARGUMENT

I. THE ASSESSMENTS ARE CONTRARY TO THE STATUTE

Statutes and Regulations Involved

The District of Columbia Income and Franchise Tax Act of 1947 (D.C. Code 1961 §§ 47-1551 *et seq.*) imposes a "franchise tax upon every corporation . . . for the privilege of carrying on or engaging in any trade or business within the District", measured by "that portion of the net income of the corporation . . . as is fairly attributable to any trade or business carried on or engaged in within the District".[9] If the

[9] D.C. Code 1961 § 47-1580, App. B, p. 31a, *infra*. In addition, the tax applies to "other income . . . derived from sources within the District", which is "allocated" entirely to the District and is not included in the apportionable income here involved. Such "other income", consisting of dividends, interest and rentals from District sources, has been taxed in this case (R. 375, 460-461) and

business "is carried on or engaged in both within and without the District, the net income derived therefrom shall . . . be deemed to be income from sources within and without the District", and "the portion thereof subject to tax . . . shall be determined under . . . regulations prescribed by the Commissioners".[10]

There can be no complaint about the statute itself. The fault lies in the exercise of the delegated power by the Commsisioners. Their power to prescribe an apportionment formula is not unlimited;[11] the formula must be one which will "properly determine" the taxable income[12]—*i.e.,* the income "fairly attributable" to business carried on or engaged in *within* the District. An apportionment regulation which fails to make a "fair and just division" is unauthorized and invalid. *Manhattan General Equipment Co.* v. *Commissioner*, 297 U.S. 129, 134.

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is not in controversy. Respondent made some argument below that business income realized through sales to District customers, if partially excluded from taxable income by an apportionment formula, was nevertheless taxable in full as "other income". The Court of Appeals (R. 512-513, n. 16) found it unnecessary to reach this question, but it noted that it had previously held that the categories of apportionable business income and "other income" are mutually exclusive, citing *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U.S. App. D.C. 360, 367, 273 F.2d 95, 102.

[10] D.C. Code 1961 § 47-1580a, App. B, pp. 32a-33a, *infra*.

[11] The District Commissioners derive their legislative powers solely by delegation from Congress (*District of Columbia* v. *John R. Thompson Co.,* 346 U.S. 100), and such powers must be exercised within the limits of the delegation. *McCeney* v. *District of Columbia,* 97 U.S. App. D.C. 282, 285, 230 F.2d 832, 835; *Thompson* v. *Amalgamated Casualty Ins. Co.*, 92 U.S. App. D.C. 307, 314, 207 F.2d 214, 220.

[12] D.C. Code 1961 § 47-1580a, App. B, pp. 32a-33a, *infra*.

Over thirty states having similar tax laws have been able, either by statute or by regulation, to find reasonable bases for the apportionment of such income.[13] Instead of following any of these precedents, the District has sought to tax much more than its fair share of the income of any business which in any way touches the District.

The formula adopted in the regulation assigns to the District that percentage of the corporation's entire net income that "the District sales . . . bear to the total sales made everywhere. . . . 'District sales' shall mean all sales to District customers the income from which is fairly attributable to the trade or business carried on or engaged in within the District. . . ."[14] In applying that regulation, the respondent construed "District sales" to mean all sales to customers located in the District, regardless of all other considerations (R. 374). This, in tax parlance, is known as the "destination sales" test. It assumes, as some of the District's witnesses testified (R. 182-185, 194-195, 204-205; see discussion, pp. 15-16, *infra*), that net income is "fairly

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[13] The best available study and summary of income apportionment for tax purposes is contained in the June 1964 Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the House of Representatives, House Report No. 1480, 88th Congress, 2d Session, in Chapters 5 and 7, especially pp. 113, 116-123, 168-170, 180-183, 235-236, 246-249. As shown therein (p. 119), 26 states use three-factor formulae based on property, payroll and sales; several others use something similar; and four (perhaps 3, see pp. 116-117), including the District, are shown as using sales alone. We believe, however, the District is the only one which exclusively and rigidly applies the customer location test, the others by administrative discretion (pp. 235-236) or otherwise having somehow managed to hold their sales (or substitute) measure to reasonable relationships to *activities*.

[14] App. B, p. 33a, *infra*.

attributable" in its entirety to the customer and his location, and in no part to manufacturing, selling, and other activities which take place elsewhere.

Character of Apportionable Income

Petitioner's total income to be apportioned is derived from business conducted by it (1) wholly outside the District (involving products both manufactured and sold elsewhere) and (2) both within and without the District (products manufactured elsewhere and sold to customers located in the District). The figure obtained by multiplying petitioner's total net income by the ratio which District sales bear to total sales affords the best available measure of the *total net income* realized from all business culminating in sales to District customers. Respondent's witness Watson testified that, as an economic matter, "the net income from any one batch of sales . . . is proportionate to the net income from any other batch of sales" (R. 172). The District's formula, in effect, applies an average rate of profit to all sales and thereby determines the total profit from all business culminating in sales to District customers.[15]

That calculation, however, attributes none of such income to activities carried on elsewhere with respect to products sold to District customers. For example, petitioner's witness, Morton, testified (R. 211):

> Q. ". . . I want to ask you to describe what is the result of applying this fraction, the numerator of which is District sales, the denominator of

[15] Such a calculation, though it might be used as a starting point for an apportionment, is unnecessary for that purpose. The apportioning fractions can be applied directly to the *entire* net income from all sources. Pp. 20-23, *infra*.

> which is the total sales, to the total net income of the corporation?"
>
> A. "The result is to ascribe all of the income arising from the business involved in the sales to the District of Columbia to the District of Columbia. That is, it ascribes 100 percent of the income arising through all of the processes that produce the sales to the District of Columbia."

Clearly, "carrying on trade or business" includes not only the final act of sale,[16] but also all those productive activities outside the District preliminary to the sale, without which there could be no sale and no income (Finding No. 5, R. 495-496; App. A, p. 3a, *infra*). The sales formula thus has no inherent tendency to accomplish the statutory division of income, *viz.*, a determination of that portion "fairly attributable" to petitioner's business activities carried on in the District.

Tax Court Decision

The Tax Court sustained petitioner's position that the sales formula was not authorized by the statute, since it merely *identified*—and did not thereafter apportion—the amount of net income derived from that segment of petitioner's business conducted both within and without the District culminating in sales to District customers, segregating it from income derived from petitioner's business conducted wholly without the District (R. 441-447; App. A, pp. 6a-13a, *infra*). Further, the Tax Court pointed out that the formula improperly exempted from tax the income derived

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[16] Even this final act normally occurred outside the District. Orders from dealers were received and filled, and title passed, outside the District (R. 266, 268, 269, 270, 276, 280, 281, 295, 299, 504). "Trade or business" includes "any . . . commercial activity." D.C. Code, 1961, § 47-1551c(h), App. B, p. 30a, *infra*.

from business activities within the District but not related to sales to District customers (R. 445, 459; App. A, pp. 10a-11a, 25a, *infra*).[17] The formula thus did not follow the statutory mandate that where the net income is derived from business carried on *within and without* the District, it is deemed to be from sources *both* within and without and must be apportioned to tax only that income "fairly attributable" to business carried on *within* the District.[18]

Instead, the formula allocated to the District 100 percent of the net income derived from the segment of petitioner's business involved in the manufacture of products without the District and their sale and shipment to customers located within the District (R. 496; App. A, p. 3a, *infra*). Clearly, a portion of such income is fairly attributable to petitioner's related out-District activities involved in the manufacture-distribution process (R. 496; App. A, p. 3a, *infra*).

On this point the testimony of the District's witness Nathan is revealing. He was asked on cross-examination whether, assuming petitioner manufactured solely in Michigan and sold its entire output to District cus-

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[17] For example, the District formula attributes none of petitioner's income to its District business carried on in offices in the the District whose activities (patents, public relations, etc.) were unrelated to its "District sales" (R. 304-306). Such activities made some contribution to the net income of petitioner, which income the statute deems to be derived partly from within the District and partly from without. The assessments put it all without. It does not matter that the deviations from the statute are in opposite directions and thus tend to offset. Each is a plain violation and the offset is very minor.

[18] D.C. Code 1961, §§ 47-1580, 47-1580a, App. B, pp. 31a-33a, *infra*.

tomers, any of the income therefrom was earned in Michigan (R. 202). He answered:

> "Certainly in part [it] is attributable to every aspect of economic activity and to the extent the [District sales] formula would put *all* the net income in the District of Columbia, to that extent one might say that it deviates from some rational allocation taking into account as many factors as one conceivably could . . ." (R. 202, emphasis added).

He also testified that the sales formula achieves the same result when only a *segment* of the manufacturer's total sales are to District customers (R. 194-195, 204-205), *viz.,* 100 percent of the income derived from that *segment* is taxed in the District, regardless of the geographical distribution of the taxpayer's related income-producing activities.

When the Tax Court asked Mr. Nathan whether a 100 percent attribution to the District is fair when related income-producing activities (manufacturing) are elsewhere, he answered: "I say that it is a fair approximation even though in that specific instance it does appear to violate what one would call fairly attributable—" (R. 204). We submit that he, like the Tax Court, fully recognized that the sales formula as here applied did not comply with the statute (R. 206-208). Professor Watson, another witness for the District, was candid in making the same admission: "Then my answer is that my testimony is inconsistent with the law" (R. 185; see also R. 182-185).

Errors of Statutory Construction by the Court of Appeals

In regard to the relationship between the taxed income and petitioner's District activities, the Court of Appeals has made two fundamental errors, both arising from the same point. In making the first error, the majority argues that petitioner's *entire* income, (a) from business conducted within and without the District, *and* (b) from business conducted wholly without the District, is to be apportioned; and that since the formula applied by the District excludes class (b) from tax, it is proper to allocate *all* of class (a) to the District.

The Tax Court had pointed out the fallacy of this reasoning and emphasized it by noting that, if a corporation's entire manufacturing operation took place in Maryland and its entire product was sold in the District, the approach used in these assessments would assign 100 percent of the net income to the District in direct conflict with the statutory command that such income be deemed to be derived from sources both within and without the District and apportioned accordingly (R. 444; App. A, p. 10a, *infra;* see discussion, pp. 16-18, *supra*). Assume, for example, that the corporation's net income from such business in 1957 is $100,000. The statute clearly requires that such income be deemed to be derived in part from Maryland and in part from the District, and only that part "fairly attributable" to business done in the District may be taxed there. Any regulation or assessment which taxes 100 percent as "fairly attributable" to the District is obviously wrong, and presumably the Court of Appeals majority would agree that the required apportionment had not been made. If by

an apportionment formula, or separate accounting, or some other acceptable method, it is determined that the correct portion is $25,000, the District is entitled to tax that much and Maryland the balance.

Now assume that in 1958 the corporation establishes a new factory in Pennsylvania, manufacturing a different product and selling it entirely to Pennsylvania customers, earning another $50,000 net income, while the Maryland-District business remains the same. It should be clear that income taxable in the District remains at $25,000, while Maryland has $75,000 and Pennsylvania $50,000. But the Court of Appeals holds that because the District did not tax the Pennsylvania income, the only requisite "apportionment" has been made, and the District may now tax 100 percent of the Maryland-District income (*i.e.*, $100,000).

The court's second error (in this branch of the case) is in drawing from the foregoing reasoning (of petitioner and the Tax Court) the inference that petitioner contends the statute *requires* that segment net income (*i.e.*, that derived from all activities culminating in sales to District customers) be first segregated and then apportioned. We did not so contend; what we did and do contend is that *if* the computation of that income is to be made (pursuant to the regulation), it is only the first step in a proper apportionment. Subsequent steps, properly applied, would achieve the correct result, but by an unnecessarily cumbersome route. Both petitioner and the Tax Court fully agree with the Court of Appeals, however, that the best way is to apportion the *entire* net income; not just the segment. The parties stipulated the total amounts of apportionable net income (R. 375), and the

Tax Court's computations were on that basis (R. 459-462).

What the Court of Appeals overlooks is that the statutory division of income can be achieved *either* by finding the amount of income related to "District sales" and apportioning that amount, *or* by apportioning entire net income, *and under any true apportionment formula the result will be exactly the same.* This was illustrated in our brief in a tabulation, using actual figures, which showed exactly why that is so.

The tabulation is reprinted in Appendix E hereto. To make the point more simply, the following is a hypothetical example, assuming for illustration only that apportionment should be on the basis of a property ratio (as was approved by this Court in *Underwood Typewriter Co.* v. *Chamberlain,* 254 U.S. 113, and *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission,* 266 U.S. 271):

Total sales (Gross receipts)	$1,000,000
Total net income	100,000
Total property	1,000,000
Sales to District customers	100,000
Property in District	10,000

Then, under the *Underwood Typewriter* and *Bass, Ratcliff & Gretton* formulae: Since 1 percent ($10,000) of the total property ($1,000,000) is in the District, 1 percent ($1,000) of the total net income ($100,000) is attributable to the District. The same result is achieved by assuming, as the District did (quite properly), that the net income from each equal segment of the business is the same—*i.e.,* that net income from manufacture and sale of goods sold to District cus-

tomers is in the same ratio as such (segment) sales to total sales—and the necessary corollary that the use of property is similarly proportioned: Since 10 percent ($100,000) of total sales ($1,000,000) are to District customers, the net income from manufacturing for and selling to District customers is 10 percent ($10,000) of total net income ($100,000), and the property used to produce such segment income is 10 percent ($100,000) of the total property ($1,000,000); and, since 10 percent ($10,000) of the property so used ($100,000) is in the District, 10 percent ($1,000) of such segment income ($10,000) is attributable to the District.

The assumption which the Court of Appeals makes is clearly incorrect: Because 10 percent of sales are to District customers, 10 percent of net income is fairly attributable to District activities. That would be true only if income-producing activities were by coincidence distributed in the same proportions as customers. They are not, as the entire record shows. The proper assumptions are those shown above.

The relevance of the discussion of segmenting petitioner's income is that it affords a test of the fairness of the formula used by respondent. It demonstrates that such a formula, unlike the single-factor *property* formula involved in *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121, "reached and was meant to reach" profits earned by activities outside the District. While wide latitude is allowed the taxing authorities in their choice of apportionment formulae, a so-called formula which demonstrably accomplishes no more than to identify the *total* net profits derived from products sold to District customers and in every

case taxes 100 percent of that amount is incapable of achieving a fair apportionment of income to District business activities.

The majority below thus held that an "apportionment" was made because the *entire* net income from all business was divided into taxable and nontaxable portions based on the location of customers (R. 511-517). If that view were sound, any so-called formula that taxed in the District less than 100 percent of petitioner's entire income (even 99 percent thereof) would be upheld as making an "apportionment". That view, however, ignores the requirement that the apportionment "properly determine" the amount "fairly attributable" to District business. The fact that the formula adopted succeeds in excluding from taxable income the portion having *no connection whatever* with the District does not suffice, when the formula designedly taxes 100 percent of the portion having even *the most limited and partial connection* with District activities. "And not only must a regulation, in order to be valid, be consistent with the statute, but it must be reasonable. . . ." *Manhattan General Equipment Co.* v. *Commissioner,* 297 U.S. 129, 134-5. The District's formula could achieve a proper apportionment only by coincidence, *viz.,* if the taxpayer's income-producing activities happen to be geographically distributed in the same proportions as are its customers.

The conflict within the Court of Appeals is well illustrated by contrasting the decision below with that in *Broadcasting Publications, Inc.* v. *District of Columbia,* 114 U.S. App. D.C. 163, 313 F.2d 554, which involved a periodical published in the District, with

97 percent of its circulation in other jurisdictions.[19] The Tax Court, relying on *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U.S. App. D.C. 360, 273 F.2d 95, divided the income according to the location of the customers. But the Court of Appeals, minimizing the importance of that consideration, stressed the productive operations which "are the main elements . . . from which a formula of allocation must be derived," and the need to identify the "function which fairly reflects the geographical sources of income" (313 F.2d at 559). Accordingly, the Court of Appeals concluded that the entire income of the taxpayer was taxable in the District, where almost all its productive activities and facilities were concentrated. A comparison of the facts of the two cases shows that *every consideration which brought Broadcasting Publications into the District puts petitioner outside the District.* See the tabulation in App. D, p. 51a, *infra*, which was presented to the Court of Appeals on reargument.

[19] Such conflict is understandable in view of the District's efforts "to work both sides of the street." It is a fair conclusion from the decided cases that the District has varied the meaning of the "fairly attributable" standard of the regulations of August 6, 1953 (App. B, pp. 33a-34a, *infra*) to maximize the tax rather than to make a fair apportionment, *e.g.*, *Smoot Sand & Gravel Co.* v. *District of Columbia*, 104 U.S. App. D.C. 292, 261 F.2d 758; *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U.S. App. D.C. 360, 273 F.2d 95; *Broadcasting Publications, Inc.* v. *District of Columbia*, *supra*. See also memorandum of March 22, 1961 from the District Finance Officer to the Commissioners attached as Appendix A to the Tax Court's opinion (R. 463-468), in which the Finance Officer describes the administrative difficulties encountered in trying fairly to apply the sales formula. The unfairness of the July 14, 1961 amendments to the regulation (App. B, pp. 34a-38a, *infra*) is described in the Tax Court's Memorandum on Remand in *Gallant, Inc.* v. *District of Columbia*, CCH D.C. Tax Rep., ¶ 200-004, pp. 10,014-10,016.

There can be differences of opinion as to what constitutes a reasonable test of "fairly attributable", but it is clear at least that any such test must work both ways—*i.e.,* if certain circumstances occurring within the District make income "fairly attributable" to the District, those same circumstances occurring without the District make that income "fairly attributable" to some place without the District and not "fairly attributable" to the District. There can be no doubt that the "main element" of petitioner's business is manufacturing (including purchasing, engineering, designing, financing and general management), which is conducted entirely outside the District (R. 261) and is unquestionably the "function which fairly reflects the geographical sources" of petitioner's income.

The Court of Appeals argued (R. 515-516) that Congress must be deemed to have approved the use of the single-factor sales formula because a similar formula had been used under an earlier gross receipts tax and "any intended change in application would have been indicated clearly by Congress". That is a complete *non sequitur.* The gross receipts tax had expired in 1939, eight years before the present tax was enacted, so there was no occasion to indicate an "intended change in application". Furthermore, it was an entirely different kind of tax, not apportioned by formula at all but imposed on "the gross receipts received from any business in the District of Columbia". 50 Stat. 673, 688, § 1(e); *Neild* v. *District of Columbia*, 71 U.S. App. D.C. 306, 110 F.2d 246. In the interim, there had been in effect since 1939 a net income tax, under which it is true that the apportionment formula was based on the sales ratio, but the sales taken into account were very different from those used under

the present formula, since only sales in which title passed in the District were included. *Electric Storage Battery Co.* v. *District of Columbia,* 81 U.S. App. D.C. 135, 155 F.2d 867. That test in practical effect excluded from tax the entire income from many sales by outside parties to District customers, such as the respondent now seeks to tax.

Congress, in adopting the 1947 Act here involved, made a very substantial change in the concept of the place of sale, by removing the passage-of-title test. *Lever Bros. Co.* v. *District of Columbia,* 92 U.S. App. D.C. 147, 151-2, 204 F.2d 39, 43-4. But it does not follow that it made a complete turnabout and authorized taxation of the entire income of a manufacturing and selling business at the place where the customer was located. In place of the arbitrary passage-of-title test, Congress prescribed a new standard, that the tax (so far as business income is concerned) must be measured by that income which is *"fairly attributable* to any trade or business carried on or engaged in within the District" (emphasis added). This was an entirely new test, which required that consideration be given to where the *business* is carried on or engaged in, and that the regulations determine what portion of the income may fairly be attributed to the business done in the District. See Tax Court opinion, R. 447-450; App. A, pp. 13a-16a, *infra.*

Perhaps the most significant change in statutory language which the 1947 Act made was the addition of the express requirement that

> "If the trade or business of any corporation is carried on or engaged in both within and without the District, the net income derived therefrom *shall,* for purposes of this article, *be deemed to be income from sources within and without the Dis-*

trict." D.C. Code 1961, § 47-1580a, App. A, *infra*, p. 32a. (Emphasis added.)

In the light of the legislative history, it is clear that Congress intended by this provision to prevent the use of such arbitrary criteria as location of customer and passage of title to pull all income from an interstate sale into the District or push all of it out, and instead to require an *apportionment*.

We have searched the legislative history in vain for any indication of Congressional intent that would support the theory of the statute adopted in the Commissioners' regulation. In the absence of such intent, and in the light of the grave constitutional questions that would be raised by any such interpretation (see pp. 28 *et seq., infra*), the statute should be read as we contend. Such a reading would, in fact, carry out the true Congressional intent—that of apportioning to each jurisdiction its fair share, but not an excessive or unduly overlapping amount, of tax.

II. THE ASSESSMENTS ARE UNCONSTITUTIONAL

A. The Assessments Are Out of All Reasonable Proportion to Business Done in the District

Constitutional Restraints

The Income and Franchise Tax Act was enacted by Congress in its capacity as the local legislature for the District of Columbia. *Gibbons* v. *District of Columbia,* 116 U.S. 404; *Mercury Press, Inc.* v. *District or Columbia,* 84 U.S. App. D.C. 203, 173 F.2d 636, *cert. denied,* 337 U.S. 931. The apportionment formula was adopted by the District Commissioners, purporting to act under delegated powers. In exercising

the power of legislating for the District, Congress (and, *a fortiori*, its delegate) is restrained by the provisions of the Bill of Rights, including the Due Process Clause of the Fifth Amendment, which is essentially the same as the corresponding clause of the Fourteenth Amendment, applicable to the states. *Bolling* v. *Sharpe*, 347 U.S. 497, 499; *Hamilton National Bank* v. *District of Columbia*, 185 U.S. App. D.C. 109, 176 F.2d 624. The decisions of this Court, therefore, concerning the constitutional restraints on state taxation of extraterritorial values are pertinent to the present case.[20]

It is fundamental that the Due Process Clause precludes a state from taxing transactions and values beyond its territorial jurisdiction. *Wallace* v. *Hines*, 253 U.S. 66; *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 342.[21] As applied to local taxes imposed upon or measured by the net income of a multistate business, that principle means that there must be a fair apportionment of the income earned within and without the jurisdiction. *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 462-463; *Hans Rees'*

[20] Much of the reasoning by which it appears that the assessments are contrary to the statute, set forth in the preceding section, applies equally to show that they are constitutionally offensive to due process requirements and therefore is not repeated here.

[21] Furthermore, even apart from the specific constitutional protection of "due process", a state may not reach transactions outside its territorial jurisdiction. *New York, Lake Erie & Western R. R. Co.* v. *Pennsylvania*, 153 U.S. 628, 646; *Miller Bros.* v. *Maryland*, *supra*, 347 U.S. at 342. The District Commissioners have no greater power.

Sons, Inc. v. *North Carolina,* 283 U.S. 123. It is, of course, recognized that a specific and precise allocation of the income of a unitary business among the states in which it functions is neither practicable nor required, and that resort to apportionment formulae is ordinarily essential. An apportionment formula may not, however, be used as a cloak for taxing extra-territorial values, and the tax will not be upheld (1) if the formula is intrinsically arbitrary or (2) if it reaches an unreasonable and arbitrary result in the particular case. *Hans Rees' Sons, Inc.* v. *North Carolina,* 283 U.S. 123, 134-135. *Cf. Fargo* v. *Hart,* 193 U.S. 491, 499-500; *Wallace* v. *Hines,* 253 U.S. 66.

Although this Court has several times considered the constitutional validity of apportionments of net income for state tax purposes, this is the first time the Court has been confronted with a decision in which an appellate court has upheld the constitutionality of an apportionment formula in the face of a square finding by the trier of the facts, based upon a record which "overwhelmingly sustains" such finding,[22] that the percentage of income subjected to tax was "out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within" the taxing jurisdiction (Finding No. 6, R. 496; App. A, p. 3a, *infra*).

History of Relevant Decisions

The first case in which this Court was confronted with the question of the constitutionality of an apportionment of net income was *Underwood Typewriter*

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[22] See dissenting opinion of Judges Danaher, Miller and Bastian in the Court of Appeals (R. 530).

Co. v. *Chamberlain,* 254 U.S. 113.[23] That case involved a Connecticut net income tax, under which the amount taxable was such proportion of the entire net income as the value of real and tangible personal property bore to the value of such property everywhere. The taxpayer's manufacturing was done in Connecticut, where 47 percent of the value of its property was located. The taxpayer contended that, since only about 3 percent of its profits were received from sales and other transactions in Connecticut, it was improper to base the tax upon 47 percent of its entire net income. It argued (as the District does here) that income was "attributable only to the processes of sale", and that "it is of no consequence where the factory is located".[24] This Court rejected that theory, declaring that "The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other States" (254 U.S. at 120). In the absence of

[23] Earlier, in *United States Glue Co.* v. *Town of Oak Creek,* 247 U.S. 321, the Court had sustained an apportioned net income tax, rejecting a contention that interstate commerce was unconstitutionally burdened by including in the tax base income from a domestic manufacturer's sales into other states. The validity of the apportionment formula (based on the two factors of property and gross business) was not placed in issue. It is of interest in the present connection, however, that the state court (161 Wis. 211, 218, 153 N.W. 241, 244), in rejecting the argument that the income from out-of-state sales had its situs elsewhere, declared: "The manufacture, the management, and the conduct of the business at the home office are the controlling features in the process of disposing of the articles produced at the factory, and constitute the source out of which the income issues, and give it a situs within this state under the income tax law."

[24] Brief and Argument on Behalf of the Plaintiff in Error, pp. 33-34, 36, 45.

other evidence that the single-factor property formula did not fairly measure the income attributable to activities in the taxing state, the Court concluded that the state had "adopted a method of apportionment which, for all that appears in this record, *reached, and was meant to reach, only the profits earned within the State*" (*id.* at 121; emphasis added).[25]

The other side of the coin was presented in *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission*, 266 U.S. 271, which involved a New York franchise tax measured by the net income of a corporation which manufactured abroad and made sales in New York and elsewhere. That tax, like the one in *Underwood*, was based on income apportioned in the ratio of property values. This Court sustained the tax, declaring that, since the taxpayer's "profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacturing resulting in no profits until it ends in sales—the State was justified in attributing to New York *a just proportion* of the profits earned by the Company from such unitary business" (266 U.S. at 282; emphasis added). Significantly, the tax was not based (as in the present case) upon the entire profit from sales into New York, but upon a property ratio which, in the absence of evidence to the contrary, was accepted as a fair indication of the location of the activities which produced the income.

A single-factor property formula came before this Court for the third time in *Hans Rees' Sons, Inc.* v.

[25] The Court also declared (254 U.S. at 120) that the criteria for a valid apportionment were the same whether the tax was a net income tax or a franchise tax measured by net income.

North Carolina, 283 U.S. 123, which involved a North Carolina tax on the net income of a corporation which manufactured in North Carolina and sold in other states. The property ratio resulted in taxing approximately 80 percent of the net income in North Carolina. The taxpayer offered accounting evidence tending to show that only 17 percent (or, by an alternative analysis, 21.7 percent) of the net income was attributable to the activities carried on in the state. The state courts struck that evidence as immaterial, under their interpretation of *Underwood* and *Bass, supra.* This Court, however, declared that "These decisions are not authority for the conclusion that where a corporation manufactures in one State and sells in another, the net profits of the entire transaction, as a unitary enterprise, may be attributed, regardless of evidence, to either State. In the *Underwood* case, it was not decided that the entire profits of the total business were to be allocated to Connecticut because that was the place of manufacture, or, in the *Bass* case, that the entire profits were to be allocated to New York because that was the place where sales were made" (283 U.S. at 132-133). The defect of proof in both cases was said to be a failure to show that the method of apportionment charged the taxpayer with income "not reasonably attributable to *the processes conducted* within the borders of that State" (*id.* at 133; emphasis added). In a unitary business of manufacturing and selling, said the Court, "all the factors in that enterprise are essential to the realization of profits" (*id.* at 133).

Based upon the tendered evidence (the nature of which is more fully discussed at pp. 38-45, *infra*), this Court found that the single-factor property formula, in the circumstances of the *Rees* case, "operated un-

reasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all appropriate proportion to the business transacted by the appellant in that State" (283 U.S. at 135). The tax was held, therefore, to be beyond the state's authority.

The North Carolina law again came before this Court in *Kent-Coffey Mfg. Co.* v. *Maxwell*, 291 U.S. 642, involving a North Carolina manufacturer with over 99 percent of its property in the state and over 99 percent of its sales elsewhere. The state court found that the manufacturer had had full opportunity to present evidence showing that its net profits arose from business conducted elsewhere and yet had completely failed to introduce any evidence whatever at either of two hearings.[26] The complete record, in fact, consisted of a petition, a tax return, a letter from the state commissioner of revenue, a check and several computations. Under these circumstances, the state court declined to hold that attribution of some 99 percent of the profit to the manufacturing state was unreasonable,[27] and this Court, in affirming *per curiam*,

[26] *North Carolina ex rel. Maxwell* v. *Kent-Coffey Mfg. Co.*, 204 N.C. 365, 374-375, 168 S.E. 397, 402. The manufacturer admitted that this was the holding of the state court. Brief and Argument for Appellant, p. 30.

[27] The state court said, "The bare fact of sale produces no income. It is merely the act by which the income is captured; the capital, the organization, or efforts which produce the sale, are the things to be considered in ascertaining the amount of income to be credited to the sale. Certainly, in a unitary business, we must look further back than to the sale itself or the activities which actually produce it. The tangible property element of capital outlay is cared for in the tangible property ratio set up by the statute. If there is anything beyond that of sufficient magnitude to affect the constitutionality of the application of this rule, it must be shown in the evidence; the burden resting upon the taxpayer to do so" (204 N.C. at 370, 168 S.E. at 400).

simply held the case to be controlled by *Underwood* rather than by *Rees*.

The next case, *Norfolk & Western Ry.* v. *North Carolina*, 297 U.S. 682, involved the apportionment of a railroad's net income on the basis of a mileage ratio. Reiterating that, as in *Rees*, it might be shown in a particular case that such a ratio worked an unfair result, since unusual handicaps might be found to make the net revenue from mileage within the state substantially lower than the average, this Court held that the proof offered was insufficient for the purpose.[28]

In *Butler Bros.* v. *McColgan*, 315 U.S. 501, this Court considered for the first time a three-factor formula (apportioning income on the basis of the average of the ratios of property, payroll and sales), comparable to—although not identical with—the formula adopted by the Tax Court herein and the formulae now used by a substantial majority of the states. This Court upheld a California franchise tax measured by net income so apportioned, despite the taxpayer's claim that separate accounting (with central buying costs and other overhead allocated among the branches) showed a loss on the California business. The Court held that the volume of business contributed by the California branch was a factor in the over-all profits of the business, and that the formula of property, payroll and sales served "to reflect 'the relative contribution of *the activities in the various states* to

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[28] The taxpayer showed that its expenses per mile in the state were far above average, but failed to show that its gross revenues per mile were not also greater. Hence there was insufficient evidence on which to base "a more accurate apportionment" of *net* income from activities within the state.

the production of the total unitary income'" (315 U.S. at 509; emphasis added).

In *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, the Court upheld the application of Minnesota and Georgia net income taxes to corporations engaging only in minimal activities (solicitation of orders, etc.) through local offices in such states. The issue decided was whether such activities sufficed to give the states *jurisdiction* to impose any income tax at all. It was undisputed that, if jurisdiction to tax existed, the three-factor formula used by each state was reasonable (*id.* at 452). Pointing out that the taxes were "levied only on that portion of the taxpayer's net income which *arises from its activities* within the taxing state" (*id.* at 464; emphasis added), the Court held that the Due Process Clause would not invalidate the taxes involved.

The Effect of the District's "Formula"

The formula involved in the present case, apportioning income in the ratio which sales to District customers bear to sales everywhere, is like none of those heretofore considered by this Court. As fully demonstrated under Point I of this brief, the single-factor sales formula does not *apportion* income at all, but merely *identifies* the segment of income produced by the series of manufacturing, selling and other activities, almost entirely carried on outside the District, which culminate in sales to District customers; and it taxes such segment of income *in its entirety*. In holding the assessments invalid, the Tax Court found *as a fact*, on a full record, that the petitioner's net income which was subjected to tax was earned by a series of transactions which took place outside the

District (Finding No. 5, R. 495-496; App. A, p. 3a, *infra*):

> "The segment of petitioner's business which was conducted both within and without the District of Columbia consisted of the manufacture of a certain number of automobiles and kindred products without the District and the sale thereof to customers within the District. The net income from this segment of petitioner's business was earned by a series of transactions beginning with the manufacture of products in several states and ending with the sale to customers in the District. While the net income was not realized until sale, it was earned in part by manufacture of the products sold, including in addition to actual manufacture, procurement of material, financing, use of property and administration."

Then it continued (Finding No. 6, R. 496; App. A, p. 3a, *infra*):

> "The method used by the assessing authority of the District attributed to the District 100 per centum of the net income derived by the petitioner from that segment of its business which consisted of the manufacture without, and sale of the products within the District. The percentage thus determined was out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within the District."

Thus the Tax Court has set up a perfect syllogism:

(a) the net income arising from business culminating in sales to District customers was in part earned outside the District;

(b) the District formula taxed 100 percent of such net income;

(c) that percentage was grossly disproportionate to the activities in the District.

The Court of Appeals does not deny the factual correctness of premises (a) and (b), findings which were not only based upon ample evidence, including the testimony of the District's own witnesses, but which, as to (b), are demonstrable from the structure of the regulation (as applied) itself.[29] Instead, it dismissed the finding as "irrelevant" (R. 517). The Court reasoned that because the Tax Court made the legal error of thinking that only the segment income was to be apportioned rather than the entire net income from all operations, whether or not ending in sales to District customers, premise (b) above was vitiated, and hence the conclusion (c) must fall. The *non sequitur* is obvious. Actually, both petitioner and the Tax Court recognized from the beginning that *total* net income was to be apportioned, as was in fact done by the Tax Court's decisions (R. 459-461), and the Court of Appeals incorrectly stated petitioner's interpretation of the statute (*supra*, pp. 20-23). Aside from that, however, it is clear that the syllogism moves from fact to fact, without the application of any view of the law, right or wrong, and that the conclusion (c) is inescapable. It is a finding of fact which should have been respected as such by the Court of Appeals.

The statement of the Court of Appeals that the finding (that the assessments reached 100 percent of the segment income) is "irrelevant" (R. 517) flies squarely in the face of this Court's decision in *Hans Rees' Sons, Inc.* v. *North Carolina, supra,* 283 U.S. at 135, where just such findings as the Tax Court made here formed the basis for invalidating an apportionment formula as applied to the taxpayer before the Court.

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[29] See discussion of the testimony, *supra*, pp. 15-18, *infra*, pp. 41-43, 52.

The majority below sought to distinguish *Hans Rees' Sons* on the ground that the proof "must be much more detailed and specific than that adduced here", and that petitioner "did not undertake to show that the District of Columbia operations accounted for a specific percentage of General Motors' total income, which percentage could, as in *Hans Rees' Sons,* be compared with that taxed under the single-factor formula. . . . Nowhere in the record do there appear specific percentages of the kind accepted by the Supreme Court in *Hans Rees' Sons*" (R. 518-522).[30]

The Evidence of Unreasonableness

It is universally recognized that no administratively feasible method of assigning income to its source achieves ultimate precision. Noting the absence of such precision in the proof offered in *Hans Rees' Sons* (where alternative analyses ascribed from 17 to 21.7 percent of income to the taxing jurisdiction), this Court declared that it was ***not necessary*** "to deter-

[30] Petitioner had been forewarned by the Court of Appeals decision in *Smoot Sand & Gravel Co.* v. *District of Columbia,* 104 U.S. App. D.C. 292, 261 F.2d 758, *cert. denied,* 359 U.S. 968, in which the taxpayer sought protection under the doctrine of *Hans Rees' Sons.* Smoot showed that all its "manufacturing" operations took place in Virginia, and offered measures by which to determine what part of its income was attributable thereto. The court thought the measures were irrelevant because it had not been shown in principle that manufacturing contributed anything at all to the production of income. Apparently, Smoot had not thought it necessary to prove that point, in view of the pronouncements of this Court that income is the product of capital and labor, a proposition which seems self-evident. However, since it was not self-evident to the Court of Appeals, we undertook to, and did, prove it by expert testimony, and then went on to prove similarly the best ways of measuring those contributions and attributing them geographically. The precise figures were stipulated, and are summarized in App. C., p. 49a, *infra.*

mine as a matter of fact the precise part of the income which should be regarded as attributable to the business conducted in North Carolina" in order to determine that the amount taxed was excessive (283 U.S. at 134-135). In the instant case, on the other hand, the Court of Appeals uses the impossibility of theoretical precision to excuse the District's so-called "formula" while at the same time using it to destroy petitioner's evidence and the Tax Court's findings and computations.

The fact is that the proof in this case, as compared to that in *Hans Rees' Sons,* is "much more detailed and specific" "to show that the District of Columbia operations accounted for a specific percentage of General Motors' total income, which percentage could . . . be compared with that taxed under the single-factor formula." The record contains and fully supports "specific percentages" far superior in accuracy to those "accepted by the Supreme Court in *Hans Rees' Sons.*" (Quotations from the court below, R. 519, 521.)

In *Hans Rees' Sons,* the evidence by which the reasonableness of the apportionment was tested was an application of separate accounting, which was feasible in the case of a simple business dealing in a single fungible product (leather).[31] Even if it were

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[31] In *Hans Rees' Sons,* the taxpayer showed (a) what its activities were, (b) market prices at various stages of production of goods of the kind in which it dealt, and (c) by accounting testimony, the approximate net income derived from each of its business activities considered separately. The taxpayer tendered evidence purporting to show that no more than 17% of its net income was produced by manufacturing and tanning of leather in the taxing state. This Court's decision does not reveal the method by which the taxpayer's witness arrived at that percentage, but the briefs and record in this Court indicate that the taxpayer attributed the

desirable, it is not feasible for a unitary manufacturing business, lacking established market prices at each level of production—whether that business be large or small—to use the technique employed by Hans Rees' Sons' accountants. Furthermore, in petitioner's case, all the elements of production were located without the District and the District activities were only incidental to those elements, so that separate accounting, if feasible, would actually attribute all or most of petitioner's income to transactions outside the District.

Separate accounting, however, is not the only nor even the best method of assigning income to source. In fact, in *Butler Bros.* v. *McColgan, supra,* 315 U.S. at 506-9, it was rejected as an *impermissible* means of testing the validity of an apportionment formula. The objective is to measure relative contributions of various elements, at various locations, to total income. The bases and measures offered by petitioner are sound, accurate, and free from the infirmities (failure to consider the effect of one operation upon the whole) pointed out in *Butler Bros.* To hold, as the court below did, that no evidence other than the separate accounting in *Hans Rees' Sons* can be used to test a formula would nullify the constitutional protection against arbitrary and excessive apportionment in the

entire profit from wholesale sales to the manufacturing process, and determined the profit on retail sales outside the manufacturing state by comparing the price received at retail (less the cost of processing at the retail level) with the average wholesale market price of the product. The taxpayer's accountant also used an alternative method, under which the manufacturing profit was determined by comparing the actual cost of leather manufactured by the taxpayer with what it could have been bought for on the open market. It was the latter method which produced the 17% figure referred to by the court below (R. 520).

case of all but the simplest businesses in our complex society.

Petitioner presented testimony of acknowledged experts in economic analysis.[32] Their testimony established that the petitioner's net income is derived from and attributable to the totality of its activities and efforts as an integrated manufacturing business—*i.e.*, from the application of the factors of production, land, capital, labor and enterprise (R. 24, 29, 40, 58-59, 67, 75, 95, 107-108, 113, 211-213, 218-219). While selling *activities*—along with manufacturing, administrative and other activities—unquestionably contribute to the production of income, these expert witnesses were firmly of the opinion that no income is created by the sale as such, which merely realizes or severs the in-

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[32] The witnesses were:

William A. Paton, who taught economics and accounting at the University of Michigan for nearly 50 years and was the author and editor of numerous books in those fields, including the standard reference book on accounting. (R. 8-11, 35-37.)

Weldon Powell, a practicing certified public accountant (partner in one of the leading national accounting firms), who was chairman of the Accounting Principles Board of the American Institute of Certified Public Accountants, with responsibilities for guiding the profession in such matters as the determination of income from business transactions. He was also trained in economics, and regularly dealt professionally in the classification, analysis, interpretation and reporting of economic data. (R. 62-66, 72-73.)

Paul Studenski, who for some 40 years had been an economist, most of that time teaching economics, public finance, public financial administration and national income analysis on a graduate level at New York University. He had served as consultant or research director for several federal and state agencies, and had written numerous books and articles, including studies of the apportionment of income for state tax purposes. (R. 88-90.)

Walter Morton, who had taught economics at the University of Wisconsin and other institutions for over 35 years and had been a consultant to various industries. (R. 209-210.)

come created by the activities referred to (R. 40-45, 59-60, 84, 94-98, 104, 212, 219, 223, 246-248).[33]

Having determined that net income is attributable to the factors of production, the next step is to achieve a rational geographical attribution of such income. The basic principle, of course, is that geographically the income is earned where the factors of production are employed to earn it. (R. 27-28, 44-45, 92-93, 117, 218, 226-227.) Since not all the factors are employed in the same proportions in all areas, some measures are necessary. The best available measures are the costs of the factors of production employed in each place. (R. 24-30, 43-44, 66-68, 93-94, 114-117, 225-227, 237.) Thus, the ideal method of making a geographical attribution of income would be to locate each dollar of cost at the place where the capital or labor it represents is employed and attribute to that place a proportionate part of the income. (R. 39-43, 76, 92-93, 225.) Since detailed cost accounting is not feasible in tax administration, a close approximation of the proper attribution of income is achieved by taking the amount of property employed as representative of land and capital costs, and payrolls as representa-

[33] To similar effect, see the quotation from *State ex rel. Maxwell* v. *Kent-Coffey Mfg. Co.*, 204 N.C. 365, 168 S.E. 397, *aff'd per curiam sub nom. Kent-Coffey Mfg. Co.* v. *Maxwell*, 291 U.S. 642, set out in footnote 27 on page 33, *supra;* and the quotation from this Court's decision in *Hans Rees' Sons, Inc.* v. *North Carolina*, *supra*, 283 U.S. at 132-3, set out in the text at p. 32, *supra*. The witnesses acknowledged that, for practical reasons, accountants do not ordinarily recognize or record income until it is realized or severed by sale, and the tax laws do not ordinarily tax it until that time; but they stated that such facts do not detract from the fact that the antecedent activities, not the sale itself, earned or produced the income (R. 47-48, 54-55, 59, 69, 83, 217, 246.)

tive of other costs of production.[34] (R. 38-39, 76, 93-94, 226-229.)

The stipulated facts established that the factors of production, in petitioner's case, even with respect to products sold to customers located in the District, were employed almost exclusively in jurisdictions other than the District; and that respondent's allocation of petitioner's income based solely on destination of sales attributed to the District many times the amount of income properly attributable to the factors of production applied therein. (R. 385-7; tabulated in App. C, p. 49a, *infra.*) In 1957, only .0218 percent of petitioner's property (including rented property) and .0477 percent of petitioner's payroll, or an average of .0348 percent, were located in the District. The amount taxed in the District was .3930 percent of petitioner's total net income, or over eleven times the amount actually produced by application of the factors of production in the District. In 1958, only .0207 percent of petitioner's owned and rented property and .0524 percent of its payroll, an average of .0366 percent, were located in the District. The amount taxed in the District was .4144 percent of petitioner's total net income, or again over eleven times the amount actually produced or earned by activities in the District.

The Court of Appeals says (R. 524): "Aside from the economic arguments that the income from these

[34] Property is not itself a cost, but its location is an accurate indication of where the costs relating to property are incurred. No distortion results from using the amount of property rather than the related costs, since the figures are reduced to a percentage (R. 231-232). The fourth factor of production, enterprise, is not separately taken into account, since it inheres in the use and direction of property and payroll (R. 241-243).

sales were (sic) attributable to operations in jurisdictions outside the District, no showing was made that the relatively minor portions of sales were not reasonably attributable to the concededly relatively minor scope of operations in the District." The question is not to what activities the *sales* are attributable, but to what activities the *net income* is attributable. Furthermore, the court seems, because of the small size of the District figures (as compared to the aggregate of petitioner's activities and income everywhere) to disregard disparities within the District as *de minimis*. When the above figures are compared with *each other*, it is apparent that the amounts taxed were not "relatively minor" but were over eleven times the amount of income produced by District activities by any acceptable quantitative measure thereof.

The excessive taxation is seen to be even more significant when it is considered that petitioner's activities connected with the great bulk of such sales were carried on by personnel traveling into the District, using only nominal amounts of property (principally their automobiles), and drawing compensation for time spent in the District in the amounts of $65,099 in 1957 and $75,694 in 1958 (R. 387). The net income derived from all business culminating in sales to District customers was $5,156,525 in 1957 and $2,707,677 in 1958 (R. 372-375; App. C, p. 49a, *infra*). The Court of Appeals would attribute to services which cost petitioner $65,099 in 1957 a net income of $5,156,525—*79 times* as great; but petitioner's total net income (before taxes) of $1,312,092,839 was *less than half* total payroll of $2,662,072,037 (R. 372, 386-387, App. C, p. 49a, *infra*). (The figures for 1958 are less dramatic but of the same order.) In other words, District busi-

ness is 158 times as profitable as the average of petitioner's entire business! This remarkable conclusion is reached notwithstanding the testimony of the District's own witnesses, and the assumption made by the District in its calculations, that the income related to every dollar of sales is the same as to every other dollar of sales (R. 172).

Based upon the stipulated facts, which were presented to the experts in the form of a hypothetical question, each of them testified that, in his opinion, the single-factor sales ratio employed by the respondent did not fairly apportion a part of petitioner's net income to the business done in the District, but rather assigned an unreasonable and excessive amount of income to such business. (R. 30-32, 37-39, 71, 75, 91-92, 95, 211-212.)

On the basis of that testimony and the stipulated facts, the Tax Court made the finding heretofore quoted (p. 36) that the percentage of income taxed under the District's single-factor formula was "out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within the District".

Single-Factor Formulae

The Court of Appeals, stating that "We need not demonstrate that the particular fact found is untrue if it is irrelevant" (R. 517), declared that it is well settled that "a single-factor formula is not inherently arbitrary or unreasonable" (R. 518). Of the cases cited from this Court, only one bears a superficial resemblance to this case, in that it involved a single factor of sales: *Ford Motor Company* v. *Beauchamp*, 308 U.S. 331. Unlike the others, discussed below, *Ford*

concerned a capital stock tax, and had nothing to do with the apportionment of income. The facts were widely different from the instant case. For example, a large assembly plant was located in the taxing state, and the gross receipts used to measure the taxable capital were entirely from intrastate transactions. 308 U.S. at 333. The Fifth Circuit Court of Appeals, *sub nom. Ford Motor Co.* v. *Clark,* 100 F.2d 515, 518, distinguished *Hans Rees' Sons, Inc.* v. *North Carolina, supra,* 283 U.S. 123, on the basis that rules for the taxation of income "are irrelevant" to the taxation of capital; and this Court did not mention *Hans Rees' Sons* at all. The *Ford* case is, therefore, irrelevant here.

The other two cases cited by the Court of Appeals as sustaining a single-factor formula involved the use of a property factor. *Underwood Typewriter Co.* v. *Chamberlain, supra,* 254 U.S. 113; *Bass, Ratcliff & Gretton, Ltd., supra,* 266 U.S. 271. An apportionment formula based on only one of the several factors of production, such as property, and ignoring the rest, may achieve a permissible rough approximation in a particular case if the disregarded elements exist in the jurisdiction in proportions not too far different from the factor which is considered. Such a formula will, however, be invalidated as "arbitrary and unreasonable" if in a particular case it produces a seriously unjust result.[35] *Hans Rees' Sons, Inc.* v. *North*

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[35] It is worth noting that the single-factor formulae involved in *Ford Motor* (intrastate sales from local stocks), *Bass* (property) and *Underwood* (property), upon which the Court of Appeals relies, would, if applied in this case, reduce petitioner's liability for District tax to near zero. So would the two-factor formula accepted in *International Harvester Co.* v. *Evatt,* 329 U.S. 416 (property and sales from local stocks), and the three-factor for-

Carolina, supra. In *Underwood,* in the absence of evidence to the contrary (such as was presented in *Rees* and in the present case), the Court sustained the single-factor property factor as one which, "for all that appears in this record, reached, and was meant to reach, only the profits *earned* within this State" (254 U.S. at 121; emphasis added).

In contrast, the single-factor *sales* formula reaches, and is designed to reach, the *entire* net income connected with every sale into the District, including income earned by the application of capital and services in other jurisdictions. The so-called "formula" does not apportion income at all, but simply identifies "the net profits from the entire transaction", a step which is merely preliminary to apportioning such profits, pp. 20-23, *supra.* Such a formula is plainly "intrinsically arbitrary" and not "fair on its face", since only by the merest chance could it possibly produce an apportionment approximating a fair distribution of income between the District and the states in which manufacturing and other income producing activities are carried on. In addition, we have proved by cogent evidence that the formula is "unreasonable and arbitrary" when applied to the facts of this case,

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mulae accepted in the Minnesota part of *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450; *Spector Motor Service, Inc.* v. *O'Connor,* 340 U.S. 602 (including sales through local offices); and *Butler Bros.* v. *McColgan,* 315 U.S. 501 (including sales solicited in-state). The three-factor formulae in the Georgia part of *Northwestern States* and in *Armco Steel Corp.* v. *Michigan,* 359 Mich. 430, 102 N.W. 2d 552, *appeal dismissed,* 364 U.S. 337 (including sales assigned to location of customer) would produce District tax liability about equal to that found by the Tax Court. See the tabulation of the application of various approved formulae to the facts of this case (using 1957 figures) in App. F, p. 57a, *infra.* No formula previously approved would begin to approach the amount assessed by the District in this case (R. 373-374).

and taxes profits in "no just sense attributable to transactions" within the District. *Hans Rees' Sons, Inc.* v. *North Carolina, supra,* 283 U.S. at 133, 134.

In sustaining the tax in the face of the record and the findings, and in the face of this Court's often-repeated statement (in accord with the view of petitioner's witnesses) that "The profits of the corporation were largely earned by a series of transactions beginning with manufacture . . . and ending with sale", the court below has placed itself in direct conflict with this Court.[36] In *Hans Rees' Sons, Inc.* v. *North Carolina, supra,* 283 U.S. at 132, this Court declared that the *Underwood* and *Bass* decisions "are not authority for the conclusion that where a corporation manufactures in one State and sells in another, the *net profits of the entire transaction,* as a unitary enterprise, may be attributed, regardless of evidence, to either State" (emphasis added). The Court of Appeals recognized the agreement in theory between this Court and petitioner's experts, but declared that "The theory proved the case in *Underwood* no better than it does here." This shows how badly the Court of Appeals missed the point of *Underwood,* which was that, since the net income was attributable to activities both in Connecticut and in other states, an apportionment of some of the income to Connecticut was not improper. Here the net income from District sales is attributable to activities both in the District and in other states (almost entirely in other states), but the Court of Appeals would tax the *entire* income in the District. *Un-*

[36] *Underwood Typewriter Co.* v. *Chamberlain, supra,* 254 U.S. at 120; *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Commission, supra,* 266 U.S. at 282; *Hans Rees' Sons, Inc.* v. *North Carolina, supra,* 283 U.S. at 129-130.

derwood, far from supporting the court's conclusion, is strong authority to the contrary.

B. The Assessments Unconstitutionally Impose upon Interstate Commerce Multiple Tax Burdens to Which Intrastate Commerce Is Not Subject.

Constitutional Restraints

Since the power to regulate commerce is one affirmatively conferred upon Congress by the Constitution, Congress itself in legislating for the District is not subject, as are the states, to restraint on the imposition of burdens upon interstate commerce. *Neild* v. *District of Columbia*, 71 U.S. App. D.C. 306, 309-12, 110 F.2d 246, 249-52. What Congress might do itself in that regard, however, cannot necessarily be delegated to local officers. In *Stoutenburgh* v. *Hennick*, 129 U.S. 141, 148, the business of selling goods in the District, on behalf of those outside the District, was held to be interstate commerce; and this Court further held that the exercise of the power to regulate such commerce "cannot be treated as a mere matter of local concern, and committed to those immediately interested in the affairs of a particular locality". Therefore, while the Court refrained from passing on whether Congress itself could have imposed the burden in question (a matter later set at rest in the *Neild* case, *supra*), it squarely held that Congress could not delegate any such power to the local governing body of the District. The *Stoutenburgh* decision was cited with approval on this point in *District of Columbia* v. *John R. Thompson Co.*, 346 U.S. 100, 107.

It is not the law as passed by Congress but the formula adopted by the District Commissioners under delegated power (and as applied by the Finance Offi-

cer) that causes the burden on interstate commerce complained of in this case. As the court below recognized (R. 525-526), nothing in the 1947 Income and Franchise Tax Act required (even assuming it permitted) the adoption of the single-factor sales formula.[37] Therefore, the decisions of this Court forbidding the exercise of local (state) power to impose burdens on interstate commerce are pertinent to this case.

This case is a good illustration of the freedom of *Congress* from interstate commerce restraints: The tax is a *franchise* tax, a tax for the privilege of engaging in commerce, and not, as in *Northwestern States* v. *Minnesota, supra,* 350 U.S. 450, a net income tax. A franchise tax cannot be imposed by a state upon purely interstate commerce. *Spector Motor Service, Inc.* v. *O'Connor,* 340 U.S. 602. However, since Congress itself enacted the franchise tax, the *nature* of the tax is not subject to Commerce Clause attack. On the other hand, the *measure* of the tax was prescribed not by Congress but by the District Commissioners, who do not enjoy and cannot have delegated to them the freedom of Congress with respect to interstate commerce.

Many of the decisions which have struck down unapportioned or malapportioned taxes have relied more or less interchangeably on the Due Process Clause and the Commerce Clause. An unreasonable and arbitrary apportionment which deprives the taxpayer of property without due process of law would also unduly burden interstate commerce. In one important

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[37] In contrast, in *Neild* v. *District of Columbia, supra,* it was Congress itself that had imposed the unapportioned "business privilege tax," and local action under delegated powers was not involved.

respect, however, reliance on the Commerce Clause does add something to the due process argument already made.

The Commerce Clause, which was designed to create a "federal free trade unit" or national common market (see *H. P. Hood & Sons, Inc.* v. *Du Mond,* 336 U.S. 525, 538-9), forbids double taxation which has the effect of discriminating against interstate commerce by subjecting it to "cumulative burdens not imposed on local concerns". *Western Live Stock* v. *Bureau of Revenue,* 303 U.S. 250, 255-6; *Michigan-Wisconsin Pipe Line Co.* v. *Calvert,* 347 U.S. 157, 170; *J. D. Adams Mfg. Co.* v. *Storen,* 304 U.S. 307, 311-2; *Gwin, White & Prince, Inc.* v. *Henneford,* 305 U.S. 434, 439. That principle was reiterated by this Court in *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450, 458, 462-3, and in *General Motors Corp.* v. *Washington,* 377 U.S. 436, 440.

Evidence of Double Taxation

There should have been no doubt of the *fact* of double taxation. It was stipulated that none of the products sold to District customers were manufactured or assembled in the District. With respect to vehicles (constituting 95-97 percent of the taxed sales, R. 377-380), it was proved (R. 3-4) and found (R. 437; App. A, pp. 2a-3a, *infra*) that such manufacture and assembly occurred very largely at plants in Michigan, Delaware and Maryland.[38] It was proved by the expert testimony, heretofore analyzed, and the Tax

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[38] With respect to the other products involved, which were relatively very minor in amount, the record is incomplete concerning the location of the plants but is clear that they are not in any case in the District.

Court found (Finding 5, R. 495-496; App. A, p. 3a, *infra*), that the net income from the sale of those products was attributable largely to such manufacturing activity, as well as to selling activity emanating from zone offices in Maryland (R. 262, 268-270, 294) and elsewhere. It was proved (R. 13-19) and found (Finding 3, R. 437-8, 495; App. A, p. 2a, *infra*) that a portion of the net income from each sale from those three states into the District, reflecting the capital and labor applied in those states toward the earning of such income, was taxed by those states, under three-factor formulae based upon the factors of property, payroll and sales, equally weighted.[39] The validity of the taxes in those other states is beyond dispute, for they were based on an apportionment of income which gave proper weight to the factors by which the income was produced. *Armco Steel Co.* v. *Michigan,* 359 Mich. 430, 102 N.W.2d 552, *appeal dismissed,* 364 U.S. 337 (sustaining the Michigan tax law); *Butler Bros.* v. *McColgan,* 315 U.S. 497; *Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450. It was also proved (R. 211, 214), was admitted by the District's witnesses (R. 164-167, 183-185, 206-207), and was found by the Tax Court (Finding 6, R. 496; App. A, p. 3a, *infra*), that the District's method resulted in taxing, not a part, but the entire net income from all activities culminating in each such sale from those other states to customers in the District.

On the basis of that record, the Tax Court found, in addition to all the stipulated details, that: the products sold to District customers were manufactured largely in Michigan, Maryland and Delaware; peti-

[39] The pertinent provisions of the statutes are set out in Appendix B, pp. 38a-48a, *infra*.

tioner paid income taxes in specified amounts to these states "in accordance with the statutes of the respective states"; "A portion of the net income of petitioner derived from the segment of the petitioner's business consisting of the manufacture of products without, and sale within the District of Columbia was taxed by the above mentioned states, pursuant to apportionment formulae (with factors of property, payroll and sales), as provided by their laws"; and "The method used by the assessing authority of the District attributed to the District 100 per centum of the net income derived by the petitioner from that segment of its business which consisted of the manufacture without, and the sale of products within the District." (R. 437-8, 495; App. A, *infra*, pp. 1a-2a.)

Without quoting or directly referring to those findings, the Court of Appeals declared that petitioner had "failed to" "show by specific evidence that 'double taxation' would result from the application of the District formula" (R. 523). The court did not dispute the underlying facts set out above, but it quibbled about the possibility that the state laws involved might define the various factors differently, or might use different accounting procedures, or allow different deductions from gross income (R. 524-525). The Tax Court, however, had the tax laws of the three states before it (R. 13, 15, 18), and was entitled to and did take judicial notice thereof. It also had before it the tax returns filed by petitioner in the three states (R. 14-19; Exhibits 9, 12, 15, 18 and 19, not printed), which showed on their face how net income was computed and how two-thirds of the income from products manufactured in those states was there taxed. It also had before it cancelled checks and receipts

showing payment of the taxes so computed (R. 14-19). It had before it the District tax returns showing how net income was computed (Exhibits 1 and 2, in evidence at Tr. 25, not printed), and stipulated figures from such returns and from the assessments which on their face show that 100 percent of income from business culminating in sales to District customers was taxed in the District (R. 373-374).

That evidence was not before the Court of Appeals for consideration, since the District had not challenged the sufficiency of the evidence to support the Tax Court's finding, and had not printed such evidence in its Joint Appendix, as it would have had to do, under Rule 16(a) of the General Rules of the Court of Appeals for the District of Columbia Circuit, in order to challenge the findings. It was, therefore, highly improper for the court below, by speculative criticism of evidence not before it, to reject the fact finding of the Tax Court, which unequivocally determined that *a portion of the same income* (i.e., income from District sales of products manufactured elsewhere) had in fact been taxed in the other states, pursuant to three-factor formulae based on property, payroll and sales.

The Duplication Was Real and Not Hypothetical

Ignoring the evidence, the Court of Appeals stated that "the company has produced only a hypothetical situation to prove its case" (R. 523). Simplified hypothetical figures were indeed used in petitioner's brief to illustrate *how* the double taxation resulted necessarily from the District's improper "formula", but the *fact* of double taxation found by the Tax Court was demonstrated by evidence (as outlined above), not

by hypothesis.[40] The "hypothetical situation", which the Court of Appeals (R. 523-524) quotes from petitioner's brief in that court, was as follows:

> "Assume that Chevrolet has a net income of $3,000,000 derived from the manufacture and sale of automobiles sold to customers located in the District; that three-fourths of the manufacturing activity takes place in Michigan and one-fourth (including the activities of the zone or 'sales' office) takes place in Maryland. Michigan would tax 50% of the income (one-third of 75% property, 75% payroll, 0% sales), Maryland would tax 16-2/3% (one-third of 25% property, 25% payroll, 0% sales); and the District would tax 100% (sales alone). Chevrolet is taxed by the three states combined on 166-2/3% of its total income."

This example effectively illustrates that the double taxation was no minor overlap, but a substantial duplication. The example was based on evidence, showing that nearly all of petitioner's relevant income-producing facilities and activities were in other states which, using three-factor formulae like that in the example, attributed almost two-thirds of the income (from sales to District customers, as well as all other sales) to capital and labor employed in those states and one-third to the sale. The illustrative figures differ, of course, from those in evidence; but the substitution of actual figures, or altering the proportions between Michigan and Maryland, or substituting Maryland or Delaware as the state of manufacture, would not affect the demonstration that, when the District taxed

[40] A comparable "simplified example" was found "commendable" by this Court in clarifying the issues in *United States* v. *Consolidated Edison Co.*, 366 U.S. 380, 382. Our example was used for that purpose, and was based on the evidence, not offered as a substitute for evidence.

100 percent of the income from sales to District customers, approximately two-thirds of the income from such sales was inevitably taxed twice.[41]

The Court of Appeals relied upon language in *Northwestern States Portland Cement Co.* v. *Minnesota, supra,* 358 U.S. at 462-463, to the effect that the taxpayer must demonstrate burdens on interstate commerce rather than force the Court to deal in abstractions (R. 525). But the record in *Northwestern States* not only distinguishes that case from this one but helps to demonstrate the difference between an "abstraction", or impermissible hypothetical, and the valid example of double taxation set forth by petitioner.

In the *Northwestern States* companion cases, the taxpayers' real objection was not that the states' three-factor formulae were unfair but rather that the taxpayers had insufficient connections with the states to allow them to be taxed on their purely interstate business.[42] During the course of its argument, however, Northwestern States did say that "The statute involved here is so designed that it *could easily lead* to

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[41] To the extent that the property and payroll were present in the jurisdiction where the sale occurred, the proportions stated would vary. But those factors were minimal here, as the stipulated facts summarized in Appendix C, *infra*, p. 49a, demonstrate. If, as suggested by the Court of Appeals, the other States used the *origin* of the sale, rather than its destination, as the standard for determining the sales factor, the duplication would be more nearly 100% than 66-2/3%, since it was stipulated that, except for the relatively minor (R. 377-80) sales of United Motors Service Division during part of the taxable period (R. 294), almost all the sales to District customers originated elsewhere, principally in the three States mentioned (R. 260-300).

[42] See 358 U.S. at 452.

multiple taxation of interstate commerce, a burden not imposed upon purely local or intrastate commerce" (*Northwestern States Portland Cement Co.* v. *Minnesota*, Brief for the Appellant, p. 13; emphasis added). To support this assertion, Northwestern States asked the Court to assume that instead of being an Iowa corporation doing business in Minnesota, it was a Minnesota corporation doing business in Iowa. It then applied the three-factor formula to its assets, concluded that 99.424 percent of its income would be taxed by Minnesota, and reasoned that "This state of facts clearly demonstrates that a net income tax can be a real burden on interstate commerce" (*id.* at 29; emphasis added).

As pointed out by Minnesota in its reply, however, Northwestern States in this hypothetical not only transposed the facts but incorrectly assigned 100 percent of its sales to Minnesota. Actually, Minnesota, unlike the District of Columbia, *allocated sales to the state in which the office of the origin of the sale was located.* Applying the correct formula, said the State, "would result in a much smaller portion of the total net income assignable to Minnesota than the appellant asserts, and when added to the portions attributable to other states having fair apportionment formulae would result in taxing no more than 100 percent of the appellant's income" (*id.*, Brief for the Respondent [Appellee], pp. 39-41).

It was this type of hypothetical abstraction by Northwestern States—far removed from the facts of the case and based on questionable assumptions—to which this Court addressed itself in its *Northwestern States* opinion. The hypothetical set forth by petitioner, on the other hand, illustrates the precise situ-

ation confronting it. It was by proof, and not by an abstraction, that petitioner showed its income being taxed not only by the District but by Delaware, Maryland and Michigan, as the Tax Court found (pp. 51-53, *supra*). We do not argue that the District's single-factor formula "could easily lead" to illegal taxation under some other set of facts, but rather that the formula *has led* to multiple taxation and undue burdens on commerce under the specific facts of this case, just as the Tax Court found (Finding No. 3, R. 437-438, 495; App. A, pp. 3a-4a, *infra*).

The duplication of tax, thus proved and found, was grossly discriminatory against interstate commerce, in that petitioner, manufacturing products in any of those states having three-factor apportionment formulae, paid a combined tax on approximately 166-2/3 percent of the net income from all business culminating in sales from that state to District customers, while another taxpayer, both manufacturing and selling in the District, would be taxed on only 100 percent of its income.

Double taxation, and discrimination against interstate commerce, of that order are unconstitutional. If two jurisdictions are taxing the same income to such an extent, one or the other is wrong—perhaps partially each. The proof here, however, is clear that the District, and only the District, is wrong.

To begin with, there is the expert testimony, heretofore reviewed (pp. 38-43), which shows the unreasonable and arbitrary character of the District's so-called formula. In addition, there is the fact that all, or nearly all, of the apportionment formulae of states imposing income taxes apportion substantial parts (usually about two-thirds) of net income to the place

of manufacture (R. 258-260; note 13 on p. 14, *supra*). The proposed "Uniform Division of Income for Tax Purposes Act", approved by the American Bar Association and the National Conference of Commissioners on Uniform State Laws, would do that (R. 458), as would the formula recommended by the District's Finance Officer but so far not adopted by the District Commissioners (R. 463-472, 485-486). This Court has repeatedly approved such formulae (pp. 30-35, *supra*).

If everybody else does it one way, and the courts, especially this Court, have consistently approved of that way, and the District method is inconsistent and incompatible, the District is under a heavy burden to show that it is right and everyone else, including the courts, is wrong. That is not all, however. Since the apportioned taxes in the other states properly reflect the contribution to net income made by the factors of production and are unquestionably valid, it is the unapportioned District tax that must yield in order to remove the discrimination. *Gwin, White & Prince, Inc.* v. *Henneford, supra*, 305 U.S. at 439-44.

C. Impact of the Decision

If the decision below is upheld, even on the narrow grounds of an asserted failure of proof, a blanket approval will be assured for the imposition of net income or franchise taxes on the entire profit realized from every interstate sale into the taxing jurisdiction, without apportionment to reflect the contribution made by business activities in other jurisdictions. The standard of proof demanded by the Court of Appeals, under which an unreasonable and arbitrarily disproportionate burden can be shown only by impossibly precise cost accounting (and must be established by

each separate taxpayer, from the facts of its own case) (*supra*, pp. 37-41), and under which multiple taxation can apparently be established only by showing identity of factor definitions, accounting procedures, and deductions (*supra*, pp. 53-54), means that such taxes will be beyond hope of successful attack on constitutional grounds.

At the present time, only the District is shown to be "apportioning" taxable net income exclusively on the basis of the factor of location of customers. (See note 13, *supra*, p. 14.) The overall impact of that so-called apportionment formula upon national commerce is, therefore, limited for the present. Other states may, however, have been deterred only by the fear that such a formula is unconstitutional. If this Court gives its approval to such a method of taxing income from interstate transactions, the method is sure to spread. States which regard themselves more as "market states" than as "producing states" will be led to adopt such method as an attractive device for making outside business pay for benefits to the local citizenry, thus exacting a toll from business done elsewhere and elsewhere amply taxed. States desiring to attract new industry will be moved to adopt the method because it imposes less tax on the locally based company which sells elsewhere and a heavier burden on the outside corporation which sells into the state. Whenever one state adopts the method, its neighbors will be moved to do the same in order to compete.[43]

[43] Such has been the history of the spread of the destination-sales factor (as distinguished from the sales-origin or sales-office factor) as one element of the widely used three-factor formula. "State Taxation of Interstate Commerce", Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary of the House of Representatives, pur-

This is not alone a problem for large national corporations like petitioner. It has recently been estimated by a Congressional subcommittee that no less than 120,000 corporations, including many small family enterprises, engage in interstate commerce and thus are potentially subject to tax in more than one jurisdiction.[44] The taxes which they may be required to pay in excess of their competitors in the local market —particularly if this method of determining tax should spread—may be important to their survival.

The objectives to increase state revenues for needed services and to attract new industry by creating a favorable tax climate are commendable in themselves, but not when they are accomplished by erecting what amounts to a tariff wall of discrimination against interstate commerce and by subsidizing local business at the expense of that originating in other states. The Constitution, as Mr. Justice Cardozo said for the unanimous Court in *Baldwin* v. *G. A. F. Seelig, Inc.*, 294 U.S. 511, 523, 527, "was framed upon the theory that the peoples of the several states must sink or swim together, and that in the long run prosperity and salvation are in union and not division. . . . Neither the power to tax nor the police power may be used by the state of destination with the aim and effect of establishing an economic barrier against competition with the products of another state or the labor of its residents. Restrictions so contrived are an un-

suant to P.L. 86-272, House Report No. 1480, 88th Cong., 2d Sess. 123-128 (June 15, 1964). The effects of the use of destination-sales as one of three factors are comparable to the present situation, but much more moderate (and perhaps permissible on that ground), since substantial (two thirds) weight is given to factors reflecting the capital and services employed to produce the income.

[44] "State Taxation of Interstate Commerce", *supra*, note 43, at pp. 77, 593.

reasonable clog upon the mobility of commerce. They set up what is equivalent to a rampart of customs duties designed to neutralize advantages belonging to the place of origin. They are thus hostile in conception as well as burdensome in result."

Those words of Mr. Justice Cardozo were reiterated by Mr. Justice Jackson, speaking for the Court, in *H. P. Hood & Sons, Inc.* v. *Du Mond,* 336 U.S. 525, 532-533, and he added (at pp. 538-539), "The material success that has come to inhabitants of the states which make up this federal free trade unit has been the most impressive in the history of commerce, but the established interdependence of the states only emphasizes the necessity of protecting interstate movement of goods against local burdens and repressions. . . . What fantastic rivalries and dislocations would ensue if such practices were begun!"

CONCLUSION

The decision of the Court of Appeals should be reversed, with directions to affirm the decision of the Tax Court, and with costs in all courts to petitioner.

Respectfully submitted,

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APPENDIX A

DISTRICT OF COLUMBIA TAX COURT

Findings of Fact and Opinion

[as filed January 29, 1962, with amendments of February 27, 1962 incorporated]

These two cases have been consolidated for hearing and disposition. They involve the same questions of taxation for the calendar years 1957 and 1958. The assessing authority of the District of Columbia assessed the petitioner substantial franchise taxes. The petitioner here appeals from the assessments and claims that they are invalid. The respondent insists that the assessments are proper and justified under Title X of the District of Columbia Income and Franchise Tax Act of 1947.[1]

Findings of Fact

Most of the facts are stipulated and, together with exhibits, are found as stipulated.

The Court finds additional facts for the taxable years involved as follows:

1. The petitioner had business establishments in 38 states and the District of Columbia. The principal office or headquarters of the petitioner was in Detroit, Michigan. There was an executive office in New York City in which were located the financial executives of the petitioner.

2. (a) The factories of the petitioner were located principally in the states of Michigan, Ohio, Illinois, Indiana, New York, New Jersey, Delaware, Maryland, Missouri, California and Georgia. There was no factory or assembly plant of the petitioner in the District of Columbia.

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[1] Title X of Chapter 15 (Sections 47-1580 and 47-1580a), D. C. Code, 1951 Edition.

(b) Approximately fifty per centum of petitioner's physical properties, including factories, equipment and inventories, and payroll amounts were located or paid in Michigan.

(c) All Cadillac automobiles and all heavy trucks of the petitioner's GMC and Coach Divisions were manufactured in Michigan. In addition, many component parts of automobiles and quantities of Buick, Oldsmobile and Pontiac automobiles were manufactured in that state.

(d) At the petitioner's factory or plant in Maryland there were assembled Chevrolet automobiles for shipment to the District of Columbia and the surrounding states.

(e) At the petitioner's factory or plant in Delaware there were assembled Buick, Oldsmobile and Pontiac automobiles for shipment to the District of Columbia and the surrounding states.

3. (a) The petitioner in accordance with the statutes of the respective states filed income tax returns and paid income taxes for the taxable years involved as follows:

Year	State	Amount
1958	Delaware	$ 127,844.95
1957	Maryland	510,792.31
1958	Maryland	271,425.75
1957	Michigan	8,955,799.55
1958	Michigan	6,940,309.50

(b) A portion of the net income of petitioner derived from the segment of the petitioner's business consisting of the manufacture of products without, and sale within the District of Columbia was taxed by the above mentioned states, pursuant to apportionment formulas (with factors of property, payroll and sales), as provided by their laws.

4. At a conference between the representatives of the petitioner and of the Finance Officer of the District of Columbia, after notice of the latter's intention to assess the deficiencies here involved, the representatives of the

petitioner protested the contemplated assessment and stated that the apportionment made was out of all proportion to the business carried on in the District by the petitioner; and that the formula used was basically unfair because it did not take into consideration or employ factors which were important in the production of income from manufacturing; and suggested that factors other than sales should be employed in apportioning the income of the petitioner and suggested that the property and payroll factors should be considered.

5. The segment of petitioner's business which was conducted both within and without the District of Columbia consisted of the manufacture of a certain number of automobiles and kindred products without the District and the sale thereof to customers within the District. The net income from this segment of petitioner's business was earned by a series of transactions beginning with the manufacture of products in several states and ending with the sale to customers in the District. While the net income was not realized until sale, it was earned in part by manufacture of the products sold, including in addition to actual manufacture, procurement of material, financing, use of property and administration.

6. The method used by the assessing authority of the District attributed to the District 100 per centum of the net income derived by the petitioner from that segment of its business which consisted of the manufacture without, and sale of the products within the District. The percentage thus determined was out of all reasonable proportion to the trade or business carried on or engaged in by petitioner within the District.

Opinion

The assessing authority of the District of Columbia assessed the petitioning taxpayer deficiencies in franchise tax and interest as follows: for the calendar year 1957 a

deficiency of $268,585.40, plus interest of $35,379.40 or a total of $303,964.80; and for the calendar year 1958 a deficiency of $167,468.44, plus interest of $11,860.89 or a total of $179,329.33. The total amount of both deficiencies, $483,294.13, was paid by the petitioner. These appeals followed. The petitioner claims that the deficiencies and interest in their entirety were erroneously assessed. On the other hand, the respondent contends that they were validly assessed.

For the reasons hereafter stated the Court holds that deficiencies and interest for the two taxable years in the total amount of $317,049.83, were erroneously assessed against, and collected from the petitioner.

Before stating the reasons for the above holding, the Court will consider and dispose of the constitutional questions raised by the petitioner to the extent that it is empowered so to do.

I

Constitutional Questions

The petitioner has raised three constitutional questions, namely, that in violation of the Constitution (a) the application of the formula results in the taxation by the District of Columbia of values without its borders or taxing jurisdiction, (b) the provision of the statute which exempts or relieves from taxation those corporations or unincorported businesses which have no office, warehouse or place of business in the District, while imposing a tax on those who do have an office, warehouse or place of business in the District is unconstitutionally discriminatory, and (c) the attributing to the District of Columbia 100 per centum of the net income of the petitioner derived from that segment of its business, which consisted of the manufacture of products without, and sale thereof within the District,

resulted in a tax out of all reasonable proportion to its business carried on or engaged in within the District. The Court does not believe it can decide those questions because of the muddled condition of the status of the Court, that is to say, whether it is a court or an administrative agency.

It is clear that Congress attempted to make the Board of Tax Appeals a court, or, at least, take away its administrative function as *"a constituent member of the assessing authority"* by the Act of July 10, 1952, (see third paragraph of Section 47-2402, D. C. Code, 1961 Edition). Such attempt, however, has been held to be abortive.

In *Hosmer* v. *District of Columbia*, 77 U. S. App. D.C. 295, 135 F. 2d 654, 71 W.L.R. 932, Judge Prettyman held that the then Board of Tax Appeals was not a court, but *"a constituent member of the assessing authority"*. He held the same in *Hamilton National Bank* v. *District of Columbia*, 85 U.S. App. D.C. 109, 176 F. 2d 624, 77 W.L.R. 1102. After those two decisions Congress attempted, at least, to negative or correct the effect of those decisions by providing in the Act of July 10, 1952, making the Board of Tax Appeals the "District of Columbia Tax Court", that *"the said District of Columbia Tax Court shall not be deemed or held to be a constituent member of the assessing or taxing authority of the District of Columbia"*. In a recent case, *District of Columbia* v. *Brady*, 109 U.S. App. D.C. 324, 288 F. 2d 108, Judge Prettyman, however, held as follows:

> "Moreover, under the Code, the ultimate exhaustion of the *administrative remedy, i.e.*, a decision by the Tax Court, an 'independent agency' in the District Government, or, indeed even the filing of an appeal with that Court, precludes the taxpayer from filing suit under his common-law remedy. If the exhaustion of the *administrative remedy* is a bar to a common-law action *a fortiori* it can in no sense be a condition precedent to such a suit.

> "We conclude that Dr. Brady's failure to exhaust his administrative remedy did not preclude his bringing action in the District Court.[2]"

The Tax Court of the United States is by the organic Act, a designated administrative agency.[3] In several cases in that Court it was held that it could decide constitutional questions, although serious doubts about that function have been expressed by some of the judges of that Court. This Court is, however, uncertain as to its power to decide a constitutional question and believes that until the matter is more clearly or definitely settled by the United States Court of Appeals or by a declaratory act of Congress, it should not decide the questions, but merely note, as it here does, that the constitutional questions were here raised. The Court, therefore, will decide the other issues persented under the law as it exists.

II

The Basis for Taxation

These cases involve franchise taxes imposed by Section 47-1571a[4] of the Code, which provides as follows:

> "For the privilege of carrying on or engaging in any trade or business within the District and receiving income from sources within the District, there is hereby levied for each taxable year a tax at the rate of 5 per centum upon the taxable income of every corporation, whether domestic or foreign."

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[2] It is interesting to note that the same result would have occurred from a holding that the Tax Court was a court and not an administrative agency.

[3] Actually it is a court. There is, and has been for sometime, a movement to have it declared to be a Federal Court.

[4] Section 2 of Title VII, D. C. Income and Franchise Tax Act of 1947.

The question which the Court must answer is: what is the portion of the petitioner's net income that was fairly attributable to the trade or business carried on by it within the District of Columbia during the taxable years involved, 1957 and 1958, and other net income from sources within the District—within the meaning of that part of Section 47-1580[5] reading as follows:

> "* * *. The measure of the franchise tax shall be that portion of the net income of the corporation * * * as is fairly attributable to any trade or business carried on or engaged in within the District and such[6] other net income as is derived from sources within the District; * * *."

The question presented in these cases relates solely to that segment of the petitioner's business which involves the manufacture of a certain number of automobiles and kindred products outside the District of Columbia and the sale thereof to customers within the District. To use the language of the many regulations, the trade or business contemplated by the Act is "the *manufacture and sale* or *purchase and sale* of tangible personal property". The Commissioners have correctly interpreted the term "trade or business" to include a combination of either "manufacture" *and* "sale" or of "purchase" *and* "sale". Otherwise, the regulations would have read "manufacture, purchase or sale". (See, among others, Section 10-2(c)(1)(a), Regulations of August 6, 1953.) The regulations in the respect indicated are consonant with the legally established fact that, "income may be defined as the gain derived from capital, from labor, or from both combined" *Strattons Independence, Ltd.* v. *Howbert*, 231 U.S. 399, 415, 58 L. Ed. 285, 34 S. Ct. 136; *Doyle* v. *Mitchell Bros. Co.*, 247 U.S. 179, 185, 62 L. Ed. 1054, 38 S. Ct. 467; *Eisner*

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[5] Section 1 of Title X, ibid.

[6] The word "such", apparently was ineptly inserted. It has no meaning or significance.

v. *Macomber*, 252 U.S. 189, 207, 64 L. Ed. 521, 40 S. Ct. 189. (And we might add "enterprise".) The cases, *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113, 65 L. Ed. 165, 41 S. Ct. 45 and *Bass, Ratcliff and Gretton, Ltd.* v. *State Tax Com.*, 266 U.S. 271, 69 L. Ed. 282, 45 S. Ct. 82, have frequently been cited to support one factor formulas, and in that connection they will be discussed with other similar cases in a later portion of this opinion. At this point they are cited to show that the "trade or business" with which we are here concerned includes both the manufacturing as well as the selling of the merchandise involved; that the net income therefrom is earned by both activities;[7] and that, while net income is not "*realized*" until sale, it is earned in part by the manufacture of the article sold. In the *Underwood Typewriter Co.*, case (254 U.S. at page 120) is the following:

> "The profits of the corporation[8] were largely earned by a series of transactions beginning with manufacturing in Connecticut and ending with sale in other states."

Likewise in the *Bass, Ratcliff & Gretton* case (266 U.S. at page 282) we find this:

> "So in the present case we are of opinion that as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were *earned* by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacturing *resulting* in no profit until it ends in sale, etc." (Emphasis supplied.)

And as the Supreme Court said in *Hans Rees' Sons* v. *North Carolina*, 283 U.S. 123, 75 L. Ed. 879, 51 S. Ct. 385:

> "Undoubtedly the enterprise of a corporation which manufactures and sells its manufactured product is

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[7] Together, of course, with administrative activities.

[8] Similar to the petitioner herein.

ordinarily a unitary business, and all the factors in that enterprise are essential to the realization of profits."

III.

Regulation and Formula Must Comply With Law

At the outset it should be pointed out that, *legally*, any formula or method for the apportionment or determination of net income taxable by the District must, in respect of multistate businesses, accord with that part of Section 47-1580a[9] of the Code, which is in this language:

> "* * *. If the trade or business of any corporation * * * is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this article be deemed to be income from sources *within* and *without* the District. * * *." (Emphasis supplied.)

In *McCeney v. District of Columbia*,[10] 97 U.S. App. D.C. 282, 285, 230 F. 2d 832, 84 W.L.R. 625, Judge Washington, commenting on the failure of the Commissioners to follow the statute in promulgating regulations, said:

> "Section 47-1601 is explicit that the tax is to be paid on the 'market value' of the interest involved. This requires, we think, that the actual market value of the interest be determined as nearly as possible. Although Section 47-1607 provides that the value of remainder interest is to be determined by subtracting from the value of the property the value of the life interests, determined in such manner as the Commissioners' regulations prescribe, *this does not authorize the Commissioners to adopt regulations which result in disregarding the directive of the statute to tax only the market value of the interest. It is axiomatic that administrative rules must be consistent*

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[9] Section 2 of Title X, District of Columbia Income and Franchise Tax Act of 1947.

[10] Involved an inheritance tax.

with the statute under which they are promulated." (Emphasis supplied.)

See also: *Manhattan General Equipment Co.* v. *Commissioner*, 297 U.S. 129, 134, 80 L. Ed. 528, 56 S. Ct. 397; *Addison* v. *Holly Hill Fruit Products, Inc.*, 322 U.S. 607, 616, 88 L. Ed. 1488, 64 S. Ct. 1215; *Thompson* v. *Amalgamated Casualty Ins. Co.*, 207 F. 2d 214, 220.

Any formula or method which does not conform to, or comply with the plain and unambiguous directive or mandate of the law is, therefore, not legally permissible. For instance, if a corporation manufactures its products at its only plant in Maryland and sells them in the District, a formula with sales as the *sole* factor would be illegal, because under it the entire net income would be assigned to, or deemed to be from sources within the District. Likewise, if property be the sole factor, the formula would be legally improper, because all of the net income would be thereunder assigned to, or deemed to be from sources in Maryland.

It is interesting to note that, if the taxpayer has its office, manufacturing plant or other principal place of business in the District and sells some of its products or performs some of its services without as well as within the District, a formula with one factor of sales only does not necessarily violate the *letter* of the provision of the law that the income must be deemed to be from sources both within and without the District. Examples of that result are *District of Columbia* v. *Southern Railway Co.*, 107 U.S. App. D.C. 285, 277 F. 2d 84, 88 W.L.R. 277; *District of Columbia* v. *Evening Star Newspaper Co.*, 106 U.S. App. D.C. 360, 273 F. 2d 95, 87 W.L.R. 1371; and *Thompson's Dairy, Inc.* v. *District of Columbia*, D.C.T.C., Docket Nos. 1731 and 1733, Opinion No. 988. In those cases a one factor formula was used, but its use resulted in loss of revenue to the District to which it was economically entitled from the use by the taxpayers of property and ad-

ministrative services within the District. A formula with the factors of property, payroll and sales would have saved that revenue, which no doubt, is why the Finance Officer of the District has repeatedly requested and urged the Commissioners to adopt the three factor formula for consistent use, that is to say, for the taxation of both resident and nonresident taxpayers.[11]

It should, moreover, be observed at this point that the provision for regulations apply in the statute to instances only where the net income of the taxpayer is "deemed to be income from sources within and without the District". Section 47-1580a of the Code, in part, provides:

> "Where the net income of a corporation or unincorporated business is derived from sources both within and without the District,[12] the portion thereof subject to tax under this article *shall* be determined under regulation or regulations prescribed by the Commissioners." (Emphasis supplied.)

Apparently, where the business is carried on *solely* in the District and the entire net income arises therein regulations or formulae are not necessary. They are only needed where the income is to be deemed to be from sources *both within* and *without* the District.

There are two suggestions or insinuations that need comment. The first is that, if all of a corporation's products manufactured outside the District are not sold therein, a one factor formula of sales would meet the requirement of the law, since it could be said that a part of the net income from the (entire) business of the corporation is deemed to

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[11] Formal submission of the three factor formula to the Commissioners and action thereon will appear from the Appendices A, B, and C to this opinion.

[12] That is to say, when the business is carried on within and without the District. See preceding portion of Section 47-1580a of the Code.

be from sources without the District. The fallacy of that idea is due to overlooking the fact that the "trade or business" covered by the act is that relating to the District, which is a combination of "manufacturing and selling" and which is carried on in the manner stated in the *Underwood Typewriter Co.*, and *Bass, Ratcliff & Gretton* cases, above cited, both within and without the District. To use an extreme case as the acid test, in *Smoot Sand & Gravel Co.* v. *District of Columbia*, 104 U.S. App. D. C. 292, 261 F. 2d 758, 85 W.L.R. 1078, all of the taxpayer's products were manufactured or processed without the District. Ninety-five per centum was sold in the District, and that percentage of its net income was held to be taxable by the District[13] under a one factor formula of sales. If all of the products had been sold, one hundred per centum of its income would have been held taxable by the District under that formula.

The other suggestion is that since *net* income results from the deduction from *gross* income of all expenses, including those relating to manufacturing, the requirement for the apportioning of net income within and without the District, where the business is carred on both within and without the District, is met by reason of such deduction. That suggestion, in the first place, overlooks the fact that all expenses, including that relating to selling the products, are deducted. Moreover, what we are trying to do in these types of cases is to find the locale of the commercial activity and what portion of the net income is fairly attributable thereto. The usual computation of net income involving the inclusion of items in gross income and deducting items of expense therefrom is not here involved. For practical

[13] The U. S. Court of Appeals evidently overlooked the mandate of the statute as to apportioning the income within and without the District, or it may have been influenced by the fact that Smoot Sand & Gravel Company had its principal office in the District where all of its fiscal affairs were handled. Two-thirds, however, of its expenses were incurred in Maryland and Virginia.

purposes what is important in cases of this kind is the determination of what portion of net income results from the use of property, from the activities of administration and the like and from the process of selling.

For the reasons stated the Court does not believe that a one factor formula of sales can, consistent with the Act, be used where, as here, the trade or business involved is the manufacture of tangible personal property without, and the sale thereof within the District.

IV

The Eastman Kodak Company and the Panitz Cases

A great deal of confusion has arisen concerning a case decided some years ago by the United States Court of Appeals under the old District of Columbia Revenue Act of 1939, namely *Eastman Kodak Co.* v. *District of Columbia*, 76 U.S. App. D.C. 339, 131 F. 2d 347. In that case this Court, then the Board of Tax Appeals, upheld an income tax against Eastman Kodak Company on the entire net income from sales of its products in the District of Columbia. The amount of net income allotted to the District was computed by assigning to the District that proportion of the taxpayer's income as sales in the District bore to sales everywhere. The United States Court of Appeals affirmed that holding. Several things must be kept in mind in relation to the *Eastman Kodak Company* case and to these cases. They arose under two differing statutes namely, the District of Columbia Revenue Act of 1939, and the District of Columbia Income and Franchise Tax Act of 1947, respectively. The taxes imposed on corporations by the two acts are different in several important and essential respects. *Flint* v. *Stone Tracy Co.*, 220 U.S. 107, 55 L. Ed. 389, 31 S. Ct. 342. The former imposed, as far as corporations were concerned, a pure income tax, while the latter levies a privilege tax, measured, it is true, by net income. The *Eastman Kodak Company* case was decided, certainly

in this Court, on the severance theory, that is to say, that no income was earned until the property involved was sold—that "the fruit must be shaken from the tree", to speak figuratively; and that the place wherein the sale took place was where the income was realized. This Court and the Court of Appeals relied upon several Federal cases which were decided before the enactment of Section 119(c) of the Internal Revenue Code of 1939 (February 10, 1939).[14] The Federal law, as it existed earlier, and upon which those cases were based, was essentially the same as the District of Columbia Revenue Act of 1939. Section 119(c) of the Internal Revenue Code of 1939, however, materially changed the Federal law; and provided that income "from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States, *or produced (in whole or in part) by the taxpayer without and sold within the United States, shall be treated as derived partly from sources within and partly from sources without the United States*", which is substantially what that part of Section 47-1580a quoted above provides, *as far as this case is concerned,* that is to say, involving the manufacture of personal property *without,* and its sale *within* the District. It is interesting to note that Eastman Kodak Company sought to have the United States Court of Appeals determine the question of tax liability on the basis of the then new Section 119(c) of the Internal Revenue Code of 1939, but that Court refused to do so and as stated above affirmed the above mentioned decision of this Court.

It should here be noted that the most important, and indeed, controlling difference between the District law involved in the *Eastman Kodak Company* case and the District of Columbia Income and Franchise Tax Act of 1947 is that the former law did not, as does the latter (Section 47-1580a of the Code) provide that where the taxpayer's

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[14] See the cases cited in Footnote 6, 76 U.S. App. D.C. page 340.

business is carried on within and without the District the net income, for the purpose of measuring the tax, must be deemed to be from sources *within* and *without* the District. Another difference between the 1939 and 1947 District laws is that under the former, since the income was earned where the sale was made, the passing of title, which usually completes a sale of personal property, was determinative, while under the latter the passing of title is of no determinative effect, which was due to, or came about by the following. The decision in the *Eastman Kodak Company* case in favor of the District was a Pyrrhic Victory. The manufacturers quickly adopted a plan whereby title and possession of goods shipped from points outside to customers within the District passed to the customers at a point outside the District. The United States Court of Appeals in *Electric Storage Battery Co. v. District of Columbia*, 81 U.S. App. D.C. 135, 155 F. 2d 867, set aside a District of Columbia income tax where the title to goods in a f.o.b. shipment passed to the customer outside the District. That and other cases, and the effect of the *Eastman Kodak Company* case and its use by the manufacturers resulted in the promotion by the District of the enactment of the District of Columbia Income and Franchise Tax Act of 1947,[15] which, as far as corporations and unincorporated businesses are concerned, has two principal advantages to the District, namely, nullification of the effect of the passing of title and the elasticity of a franchise tax which could be measured by income attributable to business carried on in the District, regardless of the locale of the sale or the real source of income in the concept of pure income taxation. Congress did, however, as above observed, provide, as protection for multistate businesses, that where the business was carried on both within and without the District the net income from such business had to be considered income from sources without, as well as within the District.

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[15] Chapter 15 of Title 47, D.C. Code, 1951 Edition.

Panitz v. *District of Columbia*, 74 U.S. App. D.C. 284, 122 F. 2d 61, 69 W.L.R. 891, has been frequently cited in support of a one factor formula of sales. Like the *Eastman Kodak Company* case, the law involved in the *Panitz* case was materially different from the Income and Franchise Tax Act,—even more so. The *Panitz* case arose under the old Business Privilege Tax Act in the District of Columbia Revenue Act of 1937. It simply imposed an excise tax measured by gross receipts from business carried on in the District "without any deduction therefrom on account of the cost of the property sold, the cost of materials, labor or services or other costs * * * or any expense whatsoever". All that was there decided was that a tax on the gross receipts from the commercial activity of sales (as required by the law) in the District was proper. There was no provision in the taxing statute requiring any apportionment, as does the present law, nor any provision similar in the slightest degree to the requirement in the current Act that, if the business is carried on both within and without the District, the net income must be apportioned accordingly.

The provision in Section 47-1580a of the Code providing that, if the trade or business is carried on within and without the District of Columbia, the net income must be deemed to be income from sources without, as well as within the District, has not only been ignored in the regulations, but has received no comment by counsel for the District in their brief in this case, although this Court has repeatedly referred to that provision as not only important, but controlling as well. The Court is at a loss to understand the failure on the part of counsel to discuss the provision in relation to these cases and to the facts stipulated by the parties.

V

Other Cases Cited To Support A One Factor Formula

Several Supreme Court cases have frequently been cited to support a one factor formula in the taxation of net income or gross receipts from unitary businesses or corporations. The cases do support the use of such a formula, *if the particular statute so provides.* In none of the cases did the taxing statute provide, as does the District law, for the apportionment within and without the taxing jurisdiction where the business is carried on within and without that area. The cases, briefly discussed, are the following:

Maine v. *Grand Trunk Rwy. Co.*, 142 U.S. 217, 35 L. Ed. 994, 12 S. Ct. 121. Really not an apportionment case. The method to be used was specifically spelled out in the Maine statute.

Underwood Typewriter Co. v. *Chamberlain, supra.* Unlike or exactly opposite from the District statute, the Connecticut law specifically provided that, if the business was carried on both within and without the State, the tax should be computed by the use of a one factor formula of property within Connecticut.

Bass, Ratcliff & Gretton, Ltd. v. *State Tax Commission, supra.* The taxing statute provided specifically for a one factor formula of real and personal property in New York.

National Leather Co. v. *Massachusetts*, 277 U.S. 413, 72 L. Ed. 935, 48 S. Ct. 534. Taxing statute specifically provided for use of a one factor formula of real and personal property employed in business in Massachusetts.

It should be added that in respect of the *Underwood Typewriter Co., Bass, Ratcliff & Gretton, Ltd.* and *National Leather Co.* cases the Supreme Court in the *Hans Rees' Sons* v. *North Carolina, supra,* indicated, as did our Court of Appeals in *Smoot Sand & Gravel Co.* v. *District of Columbia, supra,* that the decisions sustaining the one factor

formulas turned largely upon the failure of evidence. This is what the Supreme Court said in the *Hans Rees' Sons* case.

"* * * Evidence which was found lacking in the Underwood and Bass Cases is present here. *These decisions are not authority for the conclusion that, where a corporation manufactures in one state and sells in another, the net profits of the entire transaction, as a unitary enterprise, may be attributed, regardless of evidence, to either state.* In the Underwood Case, it was *not* decided that the entire net profits of the total business were to be allocated to Connecticut because that was the place of manufacture, or, in the Bass Case, that the entire net profits were to be allocated to New York because that was the place where sales were made. In both instances, a method of apportionment was involved which, as was said in the Underwood Case, 'for all that appears in this record, reached, and was meant to reach, only the profits earned within the state.' The difficulty with the evidence offered in the Underwood Case was that it failed to establish that the amount of net income with which the corporation was charged in Connecticut under the method adopted was not reasonably attributable to the processes conducted within the borders of that state; and in the Bass Case the Court found a similar defect in proof with respect to the transactions in New York." (Emphasis supplied.)

New York v. *Latrobe,* 279 U.S. 421, 73 L. Ed. 776, 49 S. Ct. 377. Unlike the District law, the New York statute specifically provided that the license fee for a corporation be based upon that proportion of its corporate stock that gross assets employed within the state bore to its gross assets employed everywhere. *It was a corporate stock valuation case.*

Ford Motor Co. v. *Beauchamp*, 308 U.S. 331, 48 L. Ed. 304, 60 S. Ct. 273. Unlike the District statute, Texas Annotated Civil Statute, Article 7084 specifically imposed "a franchise tax * * * based upon that proportion of the outstanding capital stock, surplus and undivided profits, plus the amount of outstanding bonds, notes and debentures, other than those maturing less than a year from date of issue, as gross receipts from its business done in Texas bears to the total gross receipts of the corporation from its entire business, * * *."

International Harvester Co. v. *Evatt*, 329 U.S. 416, 91 L. Ed. 390, 67 S. Ct. 444. The Ohio statute specifically provided the formula to be used. Incidentally, the Ohio statute provided a *two* factor formula, namely, of property and "business done" in Ohio.

Actually, all that the foregoing Supreme Court cases decided was that the use of the formulas specifically provided in the various statutes did not violate the Constitution.

A state case, *Household Finance Co.* v. *State Tax Com.*, 212 Md. 80, 128 A. 2d 640, relied upon to support the use of a one factor formula should be briefly discussed. That case really supports the principle that, if business is carried on within and without the District the net income must be deemed income within and without the District. The Maryland statute required the State Tax Commission, in the valuation of corporate stock relating to Maryland, to exclude business and property outside the state. The order of the State Tax Commission did not follow the law. On appeal to the Court of Appeals of Maryland the order of the Commission was modified to comply with the law. Moreover, a statutory formula or method was provided.

VI

The Gallant Case

District of Columbia v. *Gallant, Incorporated,* U.S. App. D.C. , 290 F. 2d 745, dealt with a regulation adopted by the Commissioners on August 6, 1953, for the enforcement and administration of the foregoing provisions of the Income and Franchise Tax Act.[16] The portion of the regulation with which we are here concerned is Section 10-2(c). The first sentence comports with the Act. It is the following:

> "If the trade or business is carried on or engaged in *wholly* within the District, the entire net income from trade or business shall be *allocated* to the District." (Emphasis supplied.)

The next portion of the regulation, Subsection (1)(a) of Section 10-2(c), attempts to prescribe, or has for its sole purpose the prescribing of a formula for the determination of the net income taxable by the District, that is to say, "*fairly* attributable" to any trade or business carried on in the District. The United States Court of Appeals in the *Gallant* case held that the subsection was *valid*, but that it failed in its purpose, or, to use the language in the opinion, "failed to provide a 'formula' as the term is ordinarily understood in the regulation". Later in the opinion is found this language (290 F. 2d at page 748):

> "However, irrespective of the authority of the Assessor, the Tax Court itself cannot be precluded, for lack of a regulatory formula, from determining the income which is fairly apportionable to the District. Cf. *McCeney* v. *District of Columbia,* 97 U.S. App. D.C. 282, 230 F. 2d 832 (1956). The Tax Court is, under Section 47-2403, to hear and determine 'all questions

[16] Chapter 15 of Title 47, D.C. Code, 1951 Edition.

arising' on the appeal—here the question of what income is fairly attributable to the District—and it may 'reduce or increase' the assessment as required under its determination of such questions.

"The case is remanded to the Tax Court for further proceedings not inconsistent with this opinion. The Tax Court is directed to determine the amount of the income which is fairly attributable to the District by applying the August 6, 1953, regulations, including if necessary the use of such formula or formulae as the Tax Court deems best suited for determination of that question in this case. * * *."

In Footnote numbered 4, relating to the regulation of August 6, 1953, is the following: "If a valid and pertinent regulation is promulgated by the Commissioners, the Tax Court must obey it and properly apply it." It is not supposed that the Court of Appeals meant that any regulation adopted by the Commissioners relating to the subject matter here involved should be given retroactive effect in face of the well established principle that such cannot be done if, as decided in the *Gallant* case, there was a valid regulation in effect during the prior year. *District of Columbia* v. *Radio Corporation of America*, 98 U.S. App. D.C. 119, 232 F. 2d 376, 84 W.L.R. 918, cert. denied, 352 U.S. 845, 1 L. Ed. 2d 51, 77 S. Ct. 44. But assuming that the United States Court of Appeals might have intended an exception or relaxation of the rule and intended that any new regulation be given retroactive effect, as was assumed in this Court's Memorandum on Remand in the *Gallant* case, this Court is of the opinion that, for the reasons stated in that memorandum, to which reference is here made to avoid repetition, the regulation adopted by the Commissioners on July 14, 1961, purporting to relate or pertain to the foregoing provisions of the Income and Franchise Tax Act (See Sections 47-1580 and 47-1580a of the Code) is invalid. The principal objection to the July 14,

1961, regulation is that to apply it in this case to the trade or business involved would violate the plain and unambiguous provision of Section 47-1580a of the Code that "If the trade or business of any corporation * * * is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this article, be deemed to be income from sources within and without[17] the District." The Court is of the opinion, therefore, that the use of the July 14, 1961, regulation in this case would be improper.

VII

The Best Suited Formula

In the light of the *Gallant* case, the Court believes that it is its duty to determine the amount of net income that was fairly attributable to the District of Columbia within the meaning of Section 47-1580 and 47-1580a of the Code, and to use such formula or formulae as will be agreeable to, and not violative of any provisions of those sections. This Court assumes, of course, that tha United States Court of Appeals requires that in adopting a formula this Court follow all pertinent provisions of the taxing statute. With that in mind and considering the nature and extent of the trade or business carried on by the petitioner in relation to the District, that is to say, the manufacture of a certain quantity of products and administrative activities without the District and the sale of those products within the District, the Court is of the opinion that a formula is necessary for the determination of the portion of petitioner's net income which was fairly attributable to business carried on within the District within the meaning of

[17] It is important to note that the use of the phrase "*within and without the District*" shows that the term "trade or business" includes that which is done without as well as within the District, otherwise the provision would be meaningless or at least, unnecessary, since there would never be any occasion for its use.

Section 47-1580 and 47-1580a of the Code; and that the formula best suited for that determination is the following:

The portion of petitioner's net income fairly attributable to the trade or business carried on or engaged in within the District of Columbia by the petitioner during the taxable years 1957 and 1958 shall be determined by multiplying its total net income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

1(a) The property factor is a fraction, the numerator of which is the average value of the petitioner's real and tangible personal property owned or rented and used by the petitioner in the District during the taxable year, except property from which petitioner derived net income subject to direct allocation under the regulations pertaining to the District of Columbia Income and Franchise Tax Act of 1947,[18] and the denominator of which is the average value of all the petitioner's real and tangible personal property owned or rented and used during the taxable year.

(b) Property owned by the petitioner is valued at its original cost. Property rented by the petitioner is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the petitioner, less any annual rental rate received by it from sub-rentals.

(c) The average value of property shall be determined by averaging the value at the beginning and ending of the taxable year.

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[18] For example, real estate rented to tenants, the rents therefrom being "such other income as is derived from sources within the District", within the meaning of Sections 47-1580 and 47-1580a of the Code, the net income from which is taxable separately from that derived from "trade or business". *D. C.* v. *Evening Star Newspaper Co.*, 106 U.S. App. D.C. 360, 273 F. 2d 95, 87 W.L.R. 1371.

2(a) The payroll factor is a fraction, the numerator of which is the total amount paid in the District during the taxable year by the petitioner for compensation, and the denominator of which is the total compensation paid everywhere during the taxable year.

(b) Compensation is paid in the District, if:

(i) The individual's service is performed entirely within the District.

(ii) The individual's service is performed both within and without the District, but the service performed without the District is incidental to the individual's service within the District, or

(iii) Some of the service is performed in the District and (1) the base of operations, or, if there is no base of operations, the place from which the service is directed or controlled is in the District, or (2) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in the District.

3(a) The sales factor is a fraction, the numerator of which is the total sales by the petitioner in the District during the taxable year, and the denominator of which is the total sales by the petitioner everywhere during the taxable year.

(b) Sales of tangible personal property are in the District if:

(i) The property is delivered or shipped to a purchaser, including the United States, within the District of Columbia, regardless of the f.o.b. point or other conditions of the sale.

The foregoing formula is, incidentally, substantially similar to the formula provided for multi-state businesses

in the Uniform Division of Income for Tax Purposes Act,[19] and to that recommended by the Finance Officer to the Commissioners in a memorandum dated March 22, 1961, and tentatively approved by the Commissioners on March 30, 1961 (See Appendices "A", "B" and "C" to this opinion). The formula, however, is adopted, because, in the opinion of the Court, it is intrinsically the best suited under the facts and in view of the nature of the trade or business involved herein.

The parties have stipulated facts sufficient for the application of the foregoing formula.

The Court has not overlooked the decision in the *Gallant* case that the regulation providing a one factor formula of sales is valid in that case. That decision, however, must be considered in the light of the circumstances in that case, that is to say, that the taxpayer, Gallant Incorporated, was engaged primarily in "the purchase and sale", and *not* "the mnufacture and sale", with its principal office in the District, and sold the tangible personal property involved in that case *within* and *without* the District, which permitted the use of the sales factor only, without violating the *letter* of the directive in the Act that the income had to be treated as earned, or from sources within and without the District, which would not be true in this case where the products involved were manufactured without but *sold* within the District. The use of the one factor formula in the *Gallant* case did deprive the District of Columbia of some revenue, but not all, so that, strictly speaking as observed above, the formula did not violate the letter of the law. The same is true of the *Southern Railway Co.*, *Evening Star Newspaper Co.* and *Thompson's Dairy, Inc.*, cases.

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[19] Approved, 1957, by the National Conference of Commissioners on Uniform State Laws and by the American Bar Association.

VIII

Computation of Taxes and Interest Due
Year 1957

The factors of property, payroll and sales as defined in the formula may be stated as follows:

	Everywhere	District of Columbia	District Percentage
Property[20]	$6,247,160,370	$ 1,360,676	.0218%
Payroll	$2,662,072,037	$ 1,268,180	.0477%
Sales	$9,461,855,874	$37,185,704	.3930%
Combined Percentages			.4625%
Total Percentages divided by 3 (average)			.1542%

The portion of petitioner's net income for 1957 fairly attributable to the business of manufacturing and selling its products carried on within the District is computed as follows:

Total Net Income	$1,312,092,839.00
Three Factor Apportionment Percentage	.1542%
Net Income Apportioned to District . . $	2,023,247.00
Plus Other Net Income from Sources in the District	10,320.00
Total Net Income Taxable by District	2,033,567.00
Rate of Tax	5%
Tax Due by Petitioner	101,162.25
Interest from 4/15/58 to 5/20/60 at ½ of 1% per month[21]	13,151.25
Total Tax and Interest Due for 1957 . $	114,313.50

[20] The item of "Property" includes both owned and rented property, the latter valued at 8 times the annual rent paid by petitioner.

[21] Section 47-1589c(b), D.C. Code, 1951 Edition, Supplement VIII, providing for interest on interest does not apply, because the amount assessed and demanded was exorbitant.

YEAR 1958

The factors of property, payroll and sales as defined in the formula may be stated as follows:

	Everywhere	District of Columbia	District Percentage
Property	$6,403,673,576	$ 1,326,209	.0207%
Payroll	$2,354,049,741	$ 1,233,787	.0524%
Sales	$7,853,393,381	$32,542,519	.4144%
Total Perecntages			.4875%
Total Percentages divided by 3 (average)			.1625%

The portion of the petitioner's net income for 1958 fairly attributable to business carried on within the District of Columbia by the petitioner is computed as follows:

Total Net Income	$653,396,893.00	
Three Factor Apportionment Percentage		.1625%
Net Income Apportioned to District ...$	1,061,769.00	
Plus Other Net Income from Sources in the District	15,418.00	
Total Net Income Taxable by District .	1,077,187.00	
Rate of Tax	5%	
Tax Due by Petitioner	53,859.35	
Interest from 4/15/59 to 5/20/60 at ½ of 1 % per month[22] ....$	3,770.15	
Total Tax and Interest Due for 1958 ..$	57,629.50	

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[22] Section 47-1589 (b), D.C. Code, 1951 Edition, Supplement VIII, providing for interest on interest does not apply because the amount demanded in the assessment was exorbitant.

IX

Computation of Refund

Year 1957

The amount of franchise tax and interest for the year 1957 to be refunded to the petitioner is computed as follows:

	Tax	Interest	Total
Originally and Volunarily paid by Petitioner	$ 4,198.70	None	$ 4,198.70
Deficiency paid by Petitioner	268,585.40	$35,379.40	303,964.80
Total paid by Petitioner	$272,784.10	$35,379.40	$308,163.50
Amount due by Petitioner	101,162.25	13,151.25	114,313.50
Refund payable to Petitioner	$171,621.85	$22,228.15	$193,850.00

Year 1958

The amount of franchise tax and interest for the year 1958 to be refunded to the petitioner is computed as follows:

	Tax	Interest	Total
Originally and Voluntarily paid by Petitioner	$ 1,500.00	None	$ 1,500.00
Deficiency paid by Petitioner	167,468.44	$11,860.89	179,329.33
Total paid by Petitioner	$168,968.44	$11,860.89	$180,829.33
Amount due by Petitioner	53,859.35	3,770.15	57,629.50
Refund payable to Petitioner	$115,109.09	$ 8,090.74	$123,199.83

X

Conclusion

For the reasons hereinbefore stated the Court holds as follows:

Docket No. 1698. That a deficiency in franchise tax for the calendar year 1957 in the amount of $171,621.85, and interest thereon in the amount of $22,228.15, or a total of $193,850.00, were erroneously assessed against and collected by the respondent from the petitioner; and that the petitioner is entitled to a refund thereof with interest thereon at the rate of 4 per centum per annum from May 20, 1960, to the date of the payment of the refund.

Docket No. 1699. That a deficiency in franchise tax for the calendar year 1958 in the amount of $115,109.09, and interest in the amount of $8,090.74, or a total of $123,199.83, were erroneously assessed against, and collected by the respondent from the petitioner; and that the petitioner is entitled to a refund thereof with interest thereon at the rate of 4 per centum per annum from May 20, 1960, to the date of the payment of the refund.

Decisions will be entered for petitioner.

[signed] Jo. V. Morgan
Jo. V. Morgan,
Judge

[Appendices to opinion omitted. They will be found in R. 463-72.]

APPENDIX B

Constitutional Provisions, Statutes and Regulations Involved

1. UNITED STATES CONSTITUTION:

Art. I, Sec. 8, Clause 3:

"The Congress shall have Power—

* * * *

"To regulate Commerce * * * among the several States, * * *;"

Fifth Amendment:

"No person shall * * * be deprived of life, liberty or property, without due process of law; * * *."

2. DISTRICT OF COLUMBIA INCOME AND FRANCHISE TAX ACT OF 1947, Act of July 16, 1947, 61 Stat. 328, ch. 258, as amended by Act of May 3, 1948, 62 Stat. 206, ch. 246:

Section 4(h), Article I, Title I (Section 47-1551c(h), D. C. Code 1961):

"Sec. 4. General Definitions—For the purposes of this article and wherever appearing herein, unless otherwise required by the context—

* * * *

"(h) The words 'trade or business' include the engaging in or carrying on of any trade, business, profession, vocation or calling or commercial activity in the District of Columbia; and include the performance of the functions of a public office: *Provided, however,* That the words 'trade or business' shall not include, for the purposes of this article—

"(1) Sales of tangible personal property whereby title to such property passes within or without the District, by a corporation or unincorporated business

which does not physically have or maintain an office, warehouse, or other place of business in the District, and which has no officer, agent, or representative having an office or other place of business in the District, during the taxable year; or

"(2) Sales of tangible personal property by a corporation or unincorporated business which does not maintain an office or other place of business in the District and which has no office, agent, or representative in the District except for the sole purpose of doing business with the United States, but such corporations and unincorporated businesses shall be subject to the licensing provisions in title XIV of this article.

"For purposes of this proviso, the words 'agent' or 'representative' shall not include any independent broker engaged independently in regularly soliciting orders in the District for sellers and who holds himself out as such."

Sections 1 and 2, Article I, Title X (Sections 47-1580 and 47-1580a, D.C. Code, 1961):

"Sec. 1. PURPOSE OF ARTICLE.—It is the purpose of this article to impose (1) an income tax upon the entire net income of every resident and every resident estate and trust, and (2) a franchise tax upon every corporation and unincorporated business for the privilege of carrying on or engaging in any trade or business within the District and of receiving such other income as is derived from sources within the District: *Provided, however*, That in the case of any corporation, the amount received as dividends from a corporation which is subject to taxation under this article, and, in the case of a corporation not engaged in carrying on any trade or business within the District, interest received by it from a corporation which is subject to taxation under this article shall not be con-

sidered as income from sources within the District for the purpose of this article. The measure of the franchise tax shall be that portion of the net income of the corporation and unincorporated business as is fairly attributable to any trade or business carried on or engaged in within the District and such other net income as is derived from sources within the District: *Provided further,* That income derived from the sale of tangible personal property by a corporation or unincorporated business not carrying on or engaging in trade or business within the District as defined in title I of this article shall not be considered as income from sources within the District for purposes of this article, with the exception of income from sales to the United States not excluded from gross income as provided in title III, section 2(b)(13) of this article."

"Sec. 2. ALLOCATION AND APPORTIONMENT.—The entire net income of any corporation or unincorporated business, derived from any trade or business carried on or engaged in wholly within the District shall, for the purposes of this article, be deemed to be from sources within the District, and shall, along with other income from sources within the District, be allocated to the District. If the trade or business of any corporation or unincorporated business is carried on or engaged in both within and without the District, the net income derived therefrom shall, for the purposes of this article, be deemed to be income from sources within and without the District. Where the net income of a corporation or unincorporated business is derived from sources both within and without the District, the portion thereof subject to tax under this article shall be determined under regulation or regulations prescribed by the Commissioners. The Assessor is authorized to employ any formula or formulas provided in any regulation or regulations prescribed by

the Commissioners under this article which, in his opinion, should be applied in order to properly determine the net income of any corporation or unincorporated business subject to tax under this article."

3. DISTRICT OF COLUMBIA INCOME AND FRANCHISE TAX REGULATIONS, as promulgated August 6, 1953 and relettered by amendment of July 24, 1956:

"Sec. 10.2-(c). *Income Attributed to the District of Columbia.* If the trade or business is carried on or engaged in wholly within the District, the entire net income from trade or business shall be allocated to the District. If the trade or business is carried on partly within and partly without the District, that portion of the net income from trade or business to be apportioned to the District shall be determined as follows:

"(1) Income from sales of tangible personal property.

(a) Where income for any taxable year is derived from the manufacture and sale or purchase and sale of tangible personal property, the portion thereof to be apportioned to the District shall be such percentage of the total of such income as the District sales made during such taxable year bear to the total sales made everywhere during such taxable year. Every corporation and unincorporated business which carries on or engages in business in the District within the meaning of the words 'trade or business' as defined in the Act is, unless specifically exempted by some provisions of the Act, subject to tax. For the purpose of this regulation, the phrase 'District sales' shall mean all sales to District customers the income from which is fairly attributable to the trade or business carried on or engaged in within the

District, including solicitation in the District by salesmen or other representatives of the taxpayer, that portion of sales to customers outside the District the income from which is fairly attributable to the trade or business carried on in the District, and sales of tangible personal property the income from which is from District sources."

4. DISTRICT OF COLUMBIA INCOME AND FRANCHISE TAX REGULATIONS, as revised July 14, 1961:

"Sec. 10.2-(c). Income Attributed to the District of Columbia.—

(1) *Definitions.*—When used in this section

The words 'District sales' mean all sales to District customers the income from which is fairly attributable to the trade or business carried on or engaged in by the taxpayer within the District, that portion of sales to customers outside the District the income from which is fairly attributable to the trade or business carried on by the taxpayer within the District, and sales of tangible personal property the income from which is from District sources.

The words 'District customer' mean a person who purchases from a taxpayer tangible personal property located within or without the District and delivered to such person within the District, or who purchases tangible personal property the ultimate destination of which, after all transportation including transportation by the purchaser has been completed, is a point within the District, irrespective of means of transportation, f. o. b. point, place of passage of title, or other conditions of sale.

The words 'customer outside the District' mean a person who purchases from a taxpayer tangible per-

sonal property located within or without the District and delivered to such person without the District, or who purchases tangible personal property the ultimate destination of which, after all transportation including transportation by the purchaser has been completed, is a point without the District, irrespective of means of transportation, f.o.b. point, place of passage of title, or other conditions of sale.

The words 'District customer' and the words 'customer outside the District' include the United States of America; *Provided,* That in any case where income from sales of tangible personal property to the United States is, in accordance with the Act, income subject to tax as income from District sources, such sales shall be included as District sales.

(2) *Allocation.*—If the trade or business is carried on or engaged in wholly within the District, the entire net income from trade or business shall be allocated to the District.

(3) *Apportionment.*—If the trade or business is carried on partly within and partly without the District, that portion of the net income from trade or business to be apportioned to the District shall be determined, in the case of income from the manufacture and sale or purchase and sale of tangible personal property, as follows:

Where income for any taxable year is derived by the taxpayer from the manufacture and sale or purchase and sale of tangible personal property, the portion thereof to be apportioned to the District shall be such percentage of the total of such income as the District sales made during such taxable year bear to the total sales made everywhere during such taxable year. Income from sales to District customers and income from sales to customers outside the District, shall be deemed

to be fairly attributable to the trade or business carried on or engaged in by the taxpayer within the District, or to be from District sources, and such sales shall be included as District sales, as follows:

(a) Sales to District Customers.—There shall be included as a District sale a sale of tangible personal property to a District customer where the taxpayer—

(i) Maintains within the District an office, warehouse, or other place of business for the purpose of selling personal property located within the District, or has an officer, agent, or representative (including an independent broker) having an office or other place of business in the District for the purpose of selling such property, or

(ii) Maintains within the District an office, warehouse, or other place of business or has an officer, agent, or representative (including an independent broker) in the District for the purpose of making sales of personal property by means of catalogue, descriptive literature, or sample, whether or not the personal property sold is located within the District, and whether or not orders or contracts for the purchase of such property are obtained, received, accepted, or entered into by the taxpayer within the District, or

(iii) Maintains within the District an office, warehouse, or other place of business, or has an officer, agent or representative (including an independent broker) in the District for the purpose of obtaining, receiving, accepting or entering into orders or contracts for the sale of personal property, whether or not the property which is the subject of such orders or contracts is located within the District, or

(iv) Solicits or promotes sales of personal property in the District through salesmen, officers, agents, or representatives, (including independent brokers)

whether or not such salesmen, officers, agents, or representatives have an office or other place of business within the District, and whether or not orders or contracts for the personal property sold are obtained, received, accepted, or entered into by the taxpayer within the District, or

(v) Solicits or promotes in the District sales of personal property by means of advertising, whether local or national, or solicits or promotes such sales by means of telephonic or telegraphic communication, or by correspondence with persons within the District, or

(vi) Enters into agreements, contracts, or arrangements, written or oral, with persons in the District by the terms of which such persons are required, authorized, or franchised, whether exclusively or otherwise, to purchase personal property from the taxpayer, whether or not such personal property is located within the District.

(b) Sales to Customers Outside the District.—There shall be included as a District sale a sale of tangible personal property to a customer outside the District where—

(i) a. The taxpayer is not engaged in a trade or business in the state, territory, possession of the United States, or other jurisdiction which is the place of delivery or ultimate destination of the personal property sold to the customer, and

b. The personal property sold by the taxpayer is located within the District, or

(ii) a. The taxpayer is engaged in a trade or business in a state, territory, possession of the United States, or other jurisdiction which is the place of delivery or ultimate destination of the personal property sold to the customer, and

b. The personal property sold by the taxpayer is located within the District, and

c. The income from the sale, if an income or franchise tax is imposed upon the taxpayer by such jurisdiction is not subject to inclusion in the measure of such tax.

(4) These amendments shall be applicable in any case in which the liability of the taxpayer to the District of Columbia for corporation or unincorporated business franchise tax under the District of Columbia Income and Franchise Tax Act of 1947, as amended, has not been finally determined for any year by a closing agreement or a compromise entered into pursuant to said Act, or by the application of a period of limitations prescribed in said Act, or by a decision of a court which has become final.

(5) If any provision of these amendments or the application thereof to any person or circumstances is held invalid, the remainder of these amendments, and the application thereof to other persons or circumstances, shall not be affected thereby."

5. STATE STATUTES:

a. Delaware Code, Title 30, Part II, Chapter 19, Secs. 1902, 1903:

§ 1902. Imposition of tax on corporations; exemptions.

(a) Every domestic or foreign corporation that is not exempt under subsection (b) of this section shall annually pay a tax of five per cent on its taxable income, computed in accordance with section 1903 of this title, which shall be deemed to be its net income derived from business activities carried on and property located within this State during the income year. Any receiver, referee, trustee, assignee or other fiduciary, or any officer or agent appointed by any court, who

conducts the business of any corporation, shall be subject to the tax imposed by this chapter in the same manner and to the same extent as if the business were conducted by the corporation.

(b) The following corporations shall be exempt from taxation under this chapter:

1. Fraternal beneficiary societies, orders or associations,

(A) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and

(B) providing for the payment of life, sick, accident, or other benefits to the members of such society, order or association, or their dependents;

2. Cemetery corporations and corporations organized or trusts created for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual;

3. Business leagues, chambers of commerce, fire companies, merchants' associations, or boards of trade not organized for profit, and no part of the net earnings of which inures to the benefit of any private stockholder or individual;

4. Civic leagues or organizations not organized for profit, but operated exclusively for the promotion of social welfare;

5. Clubs organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, not part of the net earnings of which inures to the benefit of any private stockholder or member;

6. A corporation maintaining a statutory corporate office in the State but not doing business within the State of Delaware;

7. Insurance companies paying taxes upon gross premiums to the Insurance Commissioner;

8. Corporations whose activities within this State are confined to the maintenance and management of their intangible investments and the collection and distribution of the income from such investments or from tangible property physically located outside this State. Added 51 Del. Laws, Ch. 298, eff. Dec. 20, 1957; amended 51 Del. Laws, Ch. 315, §§ 2, 3, eff. Feb. 5, 1958.

§ 1903. Computation of taxable income.

(a) The "entire net income" of a corporation for any income year means the amount of its federal taxable income for such year as computed for purposes of the federal income tax, adjusted by eliminating—

1. any deduction for the tax imposed by this chapter or for any net operating loss sustained prior to January 1, 1958;

2. dividends received on shares of stock or voting trust certificates;

3. interest income (including discount) other than interest on notes, bonds, accounts receivable, conditional or other sales contracts, or other instruments which evidence obligations to pay money, not regularly traded on a securities exchange or in an over-the-counter securities market, acquired in the regular and usual course of business by corporations engaged in the business of selling goods or services, lending money, financing the purchase of goods or purchasing commercial paper or evidences of indebtedness arising from the sale of goods or services;

provided that an obligation representing an advance or loan between corporations which are members of an affiliated group of corporations, as defined in section 1906 of this title, shall not be deemed to have been acquired in the course of the taxpayer's business, if the debtor corporation agrees to eliminate the interest paid thereon in determining its entire net income;

4. gains and losses from the sale or other disposition of stocks, securities, and other intangible assets not held primarily for sale to customers in the course of the corporation's business.

(b) "Taxable income" subject to taxation under this chapter means the portion of the entire net income of a corporation which is allocated and apportioned to this State in accordance with the following provisions:

1. Rents and royalties (less applicable or related expenses) from tangible property shall be allocated to the state in which the property is physically located.

2. Patent and copyright royalties (less applicable or related expenses) shall be allocated proportionately to the states in which the product or process protected by the patent is manufactured or used, or in which the publication protected by the copyright is produced or printed.

3. Gains and losses from the sale or other disposition of real property shall be allocated to the state in which the property is physically located.

4. Gains and losses from the sale or other disposition of tangible property for which an allowance for depreciation is permitted for federal income tax purposes shall be allocated to the state where the property is physically located or is normally used in the taxpayer's business.

5. Gains and losses from the sale or other disposition of intangible property, to the extent included in determining entire net income, shall be allocated to the commercial domicile of the corporation.

6. Interest (including discount), to the extent included in determining entire net income under subsection (a) of this section, less related or applicable expenses, shall be allocated to the state where the transaction took place which resulted in the creation of the obligation with respect to which the interest was earned.

7. If the entire business of the corporation is transacted or conducted within this State, the remainder of its entire net income shall be allocated to this State. If the business of the corporation is transacted or conducted in part without this State, such remainder shall be apportioned to this State on the basis of the ratio obtained by taking the arithmetical average of these three ratios:

(A) The average of the value, at the beginning and end of the income year, of all the real and tangible personal property, owned or rented, in this State by the taxpayer, expressed as a percentage of the average of the value, at the beginning and end of the income year, of all such property of the taxpayer both within and without this State, provided that any property, the income from which is separately allocated under paragraph 1 of this subsection, or which is not used in the taxpayer's business, shall be disregarded. For the purposes of this paragraph, property owned by the taxpayer shall be values at its original cost to the taxpayer, and property rented by the taxpayer shall be valued at eight times the annual rental;

(B) Wages, salaries and other compensation paid by the taxpayer to employees within this State, except general executive officers, during the income year expressed as a percentage of all such wages, salaries and other compensation paid within and without this State during the income year to all employees of the taxpayer, except general executive officers;

(C) Gross receipts from sales of tangible personal property physically delivered within this State to the purchaser or his agent (but not including delivery to the United States mail or to a common or contract carrier for shipment to a place outside this State, and gross income from other sources within this State for the income year expressed as a percentage of all such gross receipts from sales of tangible personal property and gross income from other sources both within and without the State for the income year; provided that any receipts or items of income that are excluded in determining the taxpayer's entire net income or are directly allocated under paragraphs 1 to 6 of this subsection shall be disregarded.

(c) If the allocation and apportionment provisions set forth in this section assign more than a fair and equitable proportion of the taxpayer's entire net income to this State, the Tax Commissioner, in his discretion may permit the exclusion of any one or more of the factors specified above, or the inclusion of one or more additional factors, or both; or the use of a separate accounting or of any other method necessary to produce a fair and equitable result.

(d) In determining the taxable income of a fiscal year taxpayer for that portion of its fiscal year ending within 1958 which falls within the calendar year 1958,

the taxpayer may at its election treat such period as though it were the entire fiscal year, or it may compute its taxable income for the entire fiscal year and pay the tax herein imposed on that portion of the taxable income so determined which the number of days from January 1, 1958 to the close of the fiscal year in 1958 bears to 365. Added 51 Del. Laws, Ch. 298, eff. Dec. 20, 1957; amended 51 Del. Laws, Ch. 315, § 4, eff. Feb. 5, 1958.

b. Maryland Annotated Code of 1957, Article 81, Secs. 288(e), 316:

"§ 288. Imposition of tax.

* * *

"(e) Corporate tax for years subsequent to 1954.—There is hereby annually levied and imposed for each year beginning after December 31, 1954, a tax on the net income of every corporation (domestic or foreign) at the rate of four and one-half per cent (4½%) of such portion thereof as is allocable to this State under the provisions of § 316 hereof."

§ 316. Allocation of corporate income.

The net income of a corporation (domestic or foreign) shall be allocated in the following manner:

(a) *Income from real estate or tangible personal property.*—Income from ground rents, rents and royalties and other income from real estate or tangible personal property permanently located in this State (less related expenses) shall be allocated to this State; and such income from real estate or tangible personal property permanently located outside this State (less related expenses), shall be allocated outside this State.

(b) *Business income.*—The remaining net income, hereinafter referred to as business income, shall be allocated to this State if the trade or business of the corporation is carried on wholly within this State, but

if the trade or business of the corporation is carried on partly within and partly without this State so much of the business income of the corporation as is derived from or reasonably attributable to the trade or business of the corporation carried on within this State, shall be allocated to this State and any balance of the business income shall be allocated outside this State. The portion of the business income derived from or reasonably attributable to the trade or business carried on within this State may be determined by separate accounting where practicable, but never in the case of a unitary business; however, where separate accounting is neither allowable nor practicable the portion of the business income of the corporation allocable to this State shall be determined in accordance with a three-factor formula of property, payroll and sales, in which each factor shall be given equal weight and in which the property factor shall include rented as well as owned property and tangible personal property having a permanent situs within this State and used in the trade or business shall be included as well as real property. The Comptroller of the treasury shall have the right, in those cases where circumstances warrant, to alter any of the above rules as to the use of the separate accounting method or the formula method, the weight to be given the various factors in the formula, the manner of valuation of rented property included in the property factor and the determination of the extent to which tangible personal property is permanently located within the State. (An. Code 1951, § 312; 1939, § 253; 1939, ch. 277, § 246; 1941, ch. 912, § 253(b); 1951, ch. 597, § 253(b).)

c. Michigan, Act 150 of 1953, Secs. 2 and 3 (Compiled Laws, 1948, Secs. 205.552-553):

Sec. 2. There is hereby levied and imposed upon persons engaging in business in Michigan, a specific tax on income at the following rates:

(a) Two mills on the adjusted receipts of public utilities derived from or attributable to Michigan sources.

(b) Seven and three-quarters mills on the adjusted receipts of all taxpayers other than public utilities derived from or attributable to Michigan sources.

(c) The tax computed in the manner prescribed by this section shall be reduced in the percentage, not in excess of 25%, that 1% of the taxpayer's adjusted receipts bears to the net income of the taxpayer.

The adjusted receipts of a taxpayer derived from or attributable to Michigan sources shall be determined in accordance with the provisions of section 3 of this act.

(CL '48, § 205.552.)

SEC. 3. The adjusted receipts of a taxpayer derived from or attributable to Michigan sources shall be taken to be:

(a) In the case of adjusted receipts of a taxpayer whose business transactions take place entirely within this state, the entire adjusted receipts of such taxpayer;

(b) In the case of adjusted receipts of a taxpayer who conducts business transactions (other than transportation services) which take place partially within and partially without this state, the adjusted receipts of such taxpayer derived from or attributable to Michigan sources as shown by the formulae hereinafter provided in this subparagraph (b), or at the option of the taxpayer, by separate accounting methods acceptable to the department. Where the taxpayer shall so elect or where separate accounting does not properly and fairly indicate the adjusted receipts of the taxpayer derived from or attributable to Michigan sources:

(1) The adjusted receipts of such taxpayer derived from or attributable to Michigan sources shall be deemed to be that portion of the adjusted receipts of

the taxpayer obtained by applying the average of the following 3 percentages, separately computed:

A. The average value of the taxpayer's real and tangible personal property within the state during the period covered by its report, divided by the average value of all the taxpayer's real and tangible personal property wherever situated during such period: Provided, That such property value, both within Michigan and everywhere, shall include a sum equal to 8 times the gross rents paid or accrued per annum by the taxpayer during the period covered by the taxpayer's report for the use of real property: Provided, however, That the value of buildings erected on leased land by or on behalf of the lessee shall be included in the taxpayer's real property both within Michigan and everywhere in the same manner as if owned by the taxpayer. "Gross rents" shall include the entire amount of money or other consideration includable as an expense deduction in the taxpayer's annual statement of profit and loss for the period ending on the date of the taxpayer's report, either directly or indirectly, or for its benefit for the use or possession of real property irrespective of whether such rent be stated as a fixed sum of money, a percentage of sales, profits or otherwise, and shall include any amount paid or accrued as interest, taxes, insurance or any other item of expense to the taxpayer pursuant to its use of real property belonging to another, but shall not include depreciation or amortization on buildings erected on leased land by the taxpayer or amounts separately billed for utility service, whether billed by the lessor or another.

B. The total wages, salaries and other personal service compensation during such period, computed on the cash or accrual basis according to the method used for federal tax purposes, of officers and em-

ployees within the state divided by the total wages, salaries and other personal service compensation, similarly computed, during such period of all the taxpayer's officers and employees within and without the state.

C. The gross receipts of the taxpayer, similarly computed, arising during such period from:

1. Sales of its tangible personal property where deliveries or shipments are made to points within this state;

2. Services performed within this state;

3. Rentals from property situated within this state and royalties from the use of patents or copyrights within this state; divided by the total amount of the taxpayer's gross receipts, similarly computed, arising during such period from all sales of its tangible personal property, services performed, and rentals and royalties, both within and without the state. . . . CL '48, § 205.553.

APPENDIX C*

	1957	1957 Single Factor: Destination Sales	1957 Two Factor: (1) Gross Owned and Rented Property (2) Payroll	1957 Three Factor: (1) Gross Owned and Rented Property (2) Payroll (3) Destination Sales	1958	1958 Single Factor: Destination Sales	1958 Two Factor: (1) Gross Owned and Rented Property (2) Payroll	1958 Three Factor: (1) Gross Owned and Rented Property (2) Payroll (3) Destination Sales
Apportionable Income		$1,312,092,839	$1,312,092,839	$1,312,092,839		$653,396,893	$653,396,893	$653,396,893
Apportionment Percentage		.3930%	.0348%	.1542%		.4144%	.0366%	.1625%
Apportioned Income		5,156,525	456,608	2,023,247		2,707,677	239,143	1,061,769
Income Directly Allocated		10,320	10,320	10,320		15,418	15,418	15,418
Taxable Income		$ 5,166,845	$ 466,928	$ 2,033,567		$ 2,723,095	$ 254,561	$ 1,077,187
Rate of Tax		.05	.05	.05		.05	.05	.05
Tax		$ 258,342.25	$ 23,346.40	$ 101,678.35		$ 136,154.75	$ 12,728.05	$ 53,859.35
Computation of Apportionment Percentage:								
1. Gross Owned and Rented Property								
(a) In District—								
Gross Owned	$ 378,476				$ 347,025			
Rented (rent x 8)	982,200				979,184			
Total	$ 1,360,676				$ 1,326,209			
(b) Everywhere—								
Gross Owned	$6,146,870,978				$6,295,491,112			
Rented (rent x 8)	100,289,392				108,182,464			
Total	$6,247,160,370				$6,403,673,576			
Percentage (a) ÷ (b)	.0218%		.0218%	.0218%	.0207%		.0207%	.0207%
2. Payroll								
(a) In District	$ 1,268,180				$ 1,233,787			
(b) Everywhere	2,662,072,037				2,354,049,741			
Percentage (a) ÷ (b)	.0477%		.0477%	.0477%	.0524%		.0524%	.0524%
3. Sales								
(a) To District Customers	$ 37,185,704				$ 32,542,519			
(b) To All Customers	9,461,855,874				7,853,393,381			
Percentage (a) ÷ (b)	.3930%	.3930%		.3930%	.4144%	.4144%		.4144%
Total Percentages		.3930%	.0695%	.4625%		.4144%	.0731%	.4875%
Average Percentage		.3930%	.0348%	.1542%		.4144%	.0366%	.1625%

* Stipulated data (R. 372-5, 377-80, 385-7) and computations based thereon.

APPENDIX D

Comparison of Factual Situations in *Broadcasting Publications, Inc.* v. *District of Columbia*, 114 U.S. App. D.C. 163, 313 F. 2d 554, and in *General Motors Corporation* v. *District of Columbia*

	Broadcasting		General Motors
1. "Function which fairly reflects geographic sources of income . . . essence of the . . . business for franchise tax purposes"	"Publishing and distributing the magazine"		Manufacturing (and distributing?) automobiles
Activity	**% in District**		**% in District**
2. Publishing	100%		None
3. Distributing	100%	Manufacturing	None or de minimis
4. Sales			None
Circulation	100%		
Advertising	3%		
5. Solicitation		(Indirect)	None or de minimis
Subscribers (mail)	100%		
Advertisers	3%		
6. Receipt of orders			None
Circulation	100%		
Advertising	3%		
7. Acceptance of orders			None
Circulation	100%		
Advertising	3%		
8. Shipping (mail)	100%	(Common carrier)	None
9. Billing	100%		None
10. Receipt of payment	100%		None
11. Customer records	100%		None
12. Newsgathering	70%	Engineering, etc.	None
13. Principal offices	100%		None
14. Payroll	63%		.05%
15. Property	Principally		.02%
Other Factors			
16. Customers			.4%
Subscribers	4%		
Advertisers	3%		
17. "Significant daily business contacts" outside District	No*		Substantially all
18. Outside "business contacts . . . same kind as . . . principal" business inside District	No*		No

	Broadcasting		General Motors
1. "Function which fairly reflects geographic sources of income . . . essence of the . . . business for franchise tax purposes"	"Publishing and distributing the magazine"		Manufacturing (and distributing?) automobiles
Activity	**% in District**		**% in District**
2. Publishing	100%		None
3. Distributing	100%	Manufacturing	None or de minimis
4. Sales			None
Circulation	100%		
Advertising	3%		
5. Solicitation		(Indirect)	None or de minimis
Subscribers (mail)	100%		
Advertisers	3%		
6. Receipt of orders			None
Circulation	100%		
Advertising	3%		
7. Acceptance of orders			None
Circulation	100%		
Advertising	3%		
8. Shipping (mail)	100%	(Common carrier)	None
9. Billing	100%		None
10. Receipt of payment	100%		None
11. Customer records	100%		None
12. Newsgathering	70%	Engineering, etc.	None
13. Principal offices	100%		None
14. Payroll	63%		.05%
15. Property	Principally		.02%
Other Factors			
16. Customers			.4%
Subscribers	4%		
Advertisers	3%		
17. "Significant daily business contacts" outside District	No*		Substantially all
18. Outside "business contacts . . . same kind as . . . principal" business inside District	No*		No
Held	Entire income taxable in District.		Entire income from District sales taxable in District.

* Broadcasting had offices in three other states, but the Court of Appeals disregarded them.

APPENDIX E

Comparative Computation of Apportionment (Extract from Court of Appeals Brief)

Actually, that computation of net income, and the computations of the Tax Court under the apportionment formula which it used, are shorthand computations which produce accurate results but which tend to obscure what is being done. Working them in longhand helps to clarify.

The Act directs that net income shall be determined by subtracting from gross receipts the expenses and other deductions attributable thereto. (Art. I, Title III; Sec. 47-1557 to 47-1557b, D.C. Code, 1961.) We know the amounts of total gross receipts and the part thereof derived from sales to District customers. Applying that ratio to the known total expenses and other deductions, we determine the deductions allocable to District receipts. Subtracting one from the other leaves net income from that segment of the business represented by "District receipts." Thus, for 1957 (figures for convenience are in thousands of dollars and rounded) (App. *infra* 43a):

	Longhand Method	Shorthand Method
(a) District Receipts	37,186	37,186
(b) Total Receipts	9,461,856	9,461,856
(c) Total Deductions	8,149,763	
(d) Total Income		1,312,093
(e) Segment Deductions (a ÷ b) × c	32,029	
(f) Segment Income a — e	5,157	
(g) Segment Income (a ÷ b) × d		5,157

Either method arrives at the same amount of net income derived from the segment of the business carried on both within and without the District. That is the amount which is to be apportioned. Again, the apportionment can be done either longhand (for clarity) or shorthand (for

convenience). The Tax Court used shorthand, as does Respondent in its tabulation (App. *infra* 43a), and as is generally done. Here we illustrate both, again with 1957 figures, on the assumption, supported by the uncontradicted expert testimony, that "payroll" and "property" fractions are sound measures of relative business activity:

	Longhand Method	Shorthand Method
(a) District Recepits	37,186	
(b) Total Receipts	9,461,856	
(d) Total Income		1,312,093
(f) Segment Income	5,157	
(h) District Payroll	1,268	1,268
(i) Total Payroll	2,662,072	2,662,072
(j) Segment Payroll $(a \div b) \times i$	10,462	
(k) District Property	1,361	1,361
(l) Total Property	6,247,160	6,247,160
(m) Segment Property $(a \div b) \times l$	24,551	
(n) District Income $\frac{(h \div j) + (k \div m)}{2} \times f$	457	
(o) District Income $\frac{(h \div i) + (k \div l)}{2} \times d$		457

Longhand or shorthand, the result is the same; but the longhand method shows more clearly the illogic of using a sales factor, either alone or in conjunction with other factors, for "apportionment" purposes. When the ratio of gross receipts has been applied to determine the amount

of net income to be allocated to the selected segment, it has exhausted its function and cannot validly be used again to divide up that income. Nevertheless, there are practical reasons for a three-factor formula, including sales, as Respondent pointed out to the Tax Court, and as the Tax Court found. That feature can be added to the tabulation as follows:

	Longhand Method	Shorthand Method
(p) District Income $\dfrac{((h \div j) + (k \div m) \times f) + f}{3}$	2,023	
(q) District Income $\dfrac{(h \div i) + (k \div l) + (a \div b)}{3} \times d$		2,023

The longhand method clearly reveals the duplication in the treatment of income—that is, using the income to apportion itself. The effect is arbitrarily to assign or allocate one-third of the apportionable income to the District, and then to apportion the remaining two-thirds. The identical principle is involved in, and the identical result achieved by, the shorthand method. This last is the one used by the Tax Court, and the figure shown is the one arrived at by the Tax Court.

APPENDIX F

GENERAL MOTORS CORPORATION

1957 D.C. TAX LIABILITY USING FORMULAE OF OTHER STATES

	1 California Connecticut Maryland Minnesota	2 Delaware Georgia Michigan	3 Connecticut New York North Carolina	4 Texas	5 Ohio
Apportionable Income	1,312,092,839	1,312,092,839	1,312,092,839	1,312,092,839	1,312,092,839
Apportionment Percentage	.0253%	.1542%	.0218%	.0000%	.0109%
Apportioned Income	331,959	2,023,247	286,036	—0—	143,018
Income Directly Allocated	10,320	10,320	10,320	10,320	10,320
Taxable Income	342,279	2,033,567	296,356	10,320	153,338
Rate of Tax	.05	.05	.05	.05	.05
Tax	17,113.95	101,678.35	14,817.80	516.00	7,666.90
Computation of Apportionment Percentage					
1. Property					
(a) In District	1,360,676	1,360,676	1,360,676		1,360,676
(b) Everywhere	6,247,160,370	6,247,160,370	6,247,160,370		6,247,160,370
Percentage (a) ÷ (b)	.0218%	.0218%	.0218%		.0218%
2. Payroll					
(a) In District	1,268,180	1,268,180			
(b) Everywhere	2,662,072,037	2,662,072,037			
Percentage (a) ÷ (b)	.0477%	.0477%			
3. Sales					
(a) In District	600,859	37,185,704		—0—	—0—
(b) To All Customers	9,461,855,874	9,461,855,874		9,461,855,874	9,461,855,874
Percentage (a) ÷ (b)	.0064%	.3930%		.0000%	.0000%
Total Percentages	.0759%	.4625%	.0218%	.0000%	.0218%
Average Percentage	.0253%	.1542%	.0218%	.0000%	.0109%

Note: The computations above, in support of footnote 35 on p. 43, were made by applying the factors employed by the several states to figures related to petitioner's sales, income, property and payroll, as tabulated in Appendix C, *supra*. Column 1 reflects the California formula involved in *Butler Bros.* v. *McColgan*; the Connecticut formula in *Spector Motor Service* v. *O'Connor*; the Maryland formula in Appendix B, *supra*; and the Minnesota formula in *Northwestern States Portland Cement Co.* v. *Minnesota*. In column 2, the computations reflect the Delaware formula in Appendix B, *supra*; the Georgia formula in the *Stockham Valves* portion of *Northwestern States*; and the Michigan formula in Appendix B and in *Armco Steel Corp.* v. *Michigan*. In column 3, the formulae are those used in Connecticut, New York, and North Carolina, respectively, at the time of *Underwood Typewriter Co.* v. *Chamberlain*; *Bass, Ratcliff & Gretton* v. *State Tax Commission*; and *Hans Rees' Sons* v. *North Carolina*. In columns 4 and 5, the Texas and Ohio formulae involved in *Ford Motor Co.* v. *Beauchamp* and *International Harvester Co.* v. *Evatt*, respectively, although in fact applicable to the apportionment of *capital* values, have been applied for illustrative purposes to apportion petitioner's net income.